Supreme Court, U.S.
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No. _____

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1995

DONALD TAFFI; MADELAINE TAFFI,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to The United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

In a reorganization proceeding under the Bankruptcy Code, what is the proper method under 11 U.S.C. § 506(a) for valuing a secured creditor's interest in property of the estate which the debtor intends to retain under the plan of reorganization.

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Petition for Writ of Certiorari to The United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

Donald Taffi and Madelaine Taffi respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINION BELOW

The en banc opinion of the Ninth Circuit Court of Appeals is not reported at this time. App., infra, at pp. 1 to 8. The panel opinion of the Court of Appeals is officially reported at 68 F.3d 306. App., infra, at pp. 9 to 15. The opinion of the United States District Court for the Central District of California is not officially reported. It is unofficially reported at 1993 WL 55884. App., infra, at pp. 16 to 26. The opinion of the United States Bankruptcy Court for the Central District of California is officially reported at 144 B.R. 105. App., infra, at pp. 27 to 37.

JURISDICTION

The en banc opinion of the Court of Appeals was entered on September 17, 1996. No petition for rehearing and no request for an extension of time to file a petition for writ of certiorari was filed. Jurisdiction is conferred upon this Court pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

This action concerns 11 U.S.C. § 506(a). Those sections provide in pertinent part:

§ 506. Determination of secured status.

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property... and as an unsecured claim to the extent that the value of such creditor's interest... is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the value and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT

The petitioners Donald and Madelaine Taffi filed a voluntary Chapter 11 bankruptcy petition on May 22, 1991. As of the date of the petition, the IRS claimed that the Taffis owed $496,948.05 in taxes, penalties and interest. The IRS had properly filed a tax lien notice prior to the petition date.

The Taffis' only asset of any significant value was their residence. The parties stipulated that the fair market value of the residence, i.e., the amount a fully informed buyer would pay under normal market conditions, was $300,000.00. Similarly, the parties stipulated that if the IRS were to seize and sell the residence it would sell for $240,000.00. Finally, the parties

stipulated that, if the Taffis were themselves to sell their residence at the fair market value, the costs associated with such a sale would be $27,000.00. The Taffis' residence was subject to four senior trust deeds securing debts totaling $233,942.38. The Taffis' other assets were valued at $10,000 by stipulation.

The Taffis and the IRS disputed the method for determining the amount of the IRS's allowed secured claim under 11 U.S.C. § 506(a). The Taffis argued that the IRS had a secured claim of $16,057.62, the forced sale value of the residence less senior liens plus the value of other assets. The IRS argued that it had a secured claim of $76,057.62, the fair market value of the residence less senior liens plus the value of other assets.

The Bankruptcy Court held that, under § 506(a), the residence's forced sale value was to be used to determine the IRS's secured claim. The District Court reversed and held that the residence's fair market value was to be used to determine the IRS's secured claim.

An appeal was taken to the Court of Appeals for the Ninth Circuit. The Court of Appeals had jurisdiction pursuant to 28 U.S.C. §§ 158(d) and 1291. A divided panel of the Court of Appeals affirmed the District Court. Thereafter, sitting en banc, the Court of Appeals affirmed the District Court. In its opinion, the en banc panel recognized that its decision was in direct conflict with the opinion of the Fifth Circuit Court of Appeals in In re Rash, 90 F.3d 1036 (1996).

REASONS WHY THE WRIT SHOULD BE GRANTED

A. This Court Should Grant the Writ to Resolve an Acknowledged Conflict Among the Circuits on an Issue of Vital Importance in Bankruptcy Cases

This case presents an issue of nationwide importance that affects the rights of debtors and creditors in tens of thousands of reorganization proceedings filed under the Bankruptcy Code: the proper method under 11 U.S.C. § 506(a) for valuing secured claims in property to be used by the debtors in reorganization proceedings. According to statistics published by the American Bankruptcy Institute, there were 11,535 business Chapter 11 cases and 10,363 business Chapter 13 cases filed in 1995. There were 1,369 non-business Chapter 11 cases and 276,225 non-business Chapter 13 cases filed in 1995. Since the method of valuing secured claims could impact the proceedings in each of these cases, the importance of this issue cannot be overstated.

The Ninth Circuit held that a secured claim is equal to the fair market value of the collateral less the amount of senior liens. The Ninth Circuit reasoned that since the property was to be used by the debtors, and not be foreclosed upon or sold, a secured creditor was entitled to the fair market value of the property, less the amount of senior liens, without reduction for sales costs. Slip. op. at 6, App. at p. 6. The Ninth Circuit recognized that its en banc decision conflicted with the en banc decision of the Fifth Circuit Court of Appeals in In re Rash, 90

F.3d 1036 (1996)[1], which held that a secured creditor's secured claim should be valued at the amount that would be realized if it foreclosed. Slip op. at 7, App. at p. 7.

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[1] The Ninth Circuit claimed that its en banc decision was "in harmony" with opinions rendered in four other circuits: In re Trimble, 50 F.3d 530, 531-2 (8th Cir. 1995); In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 75-76 (1st Cir. 1995); In re McClurkin, 31 F.3d 401, 405 (6th Cir. 1994); In re Coker, 973 F.2d 258, 260 (4th Cir. 1992). The Ninth Circuit misspoke if it meant to imply that these four cases each held that a secured creditor's interest should be valued, for purposes of determining plan payments, by subtracting senior liens from the property's fair market value. Both In re Coker, and In re McClurkin were chapter 13 cases that addressed the issue of whether, in determining the extent to which a claim was secured, the court is to deduct from the value of the property hypothetical sale costs. In Coker the parties agreed that fair market value was to be used while in McClurkin the parties accepted an appraised value for the property. In In re Winthrop Old Farm Nurseries, Inc., the First Circuit held that in light of the debtor's use of the property to generate income, the bankruptcy court did not abuse its discretion in valuing the property at fair market value rather than liquidation value. In In re Trimble, the Court relied on the panel decision in In re Rash to conclude that the retail rather than the wholesale value of the property should be used in a chapter 13 case where the debtor intended to use the property. Thus, at most, only one other circuit, the Eighth Circuit in Trimble, has reached a decision that, like the Ninth Circuit's decision in this case, conflicts with the en banc decision in Rash.

In Rash, the Fifth Circuit conducted an exhaustive analysis of the language of § 506(a), of the economic relationship of the debtor and the secured creditor and of the legislative history § 506(a). It reasoned that the value of a creditor's secured interest in property is necessarily different than the debtor's, since a creditor can realize the value of its interest only "if it repossessed and sold the collateral pursuant to its security agreement." 90 F.3d. at 1060-61. Thus, the Fifth Circuit concluded that this should be the starting point for valuation under § 506(a) if the debtor intends to retain the property under a reorganization plan. A petition for writ of certiorari was filed in In re Rash on September 20, 1996.

In its en banc opinion, the Ninth Circuit recognized that its decision was in conflict with the decision reached by the Fifth Circuit in In re Rash. The issue is one that will arise in virtually every reorganization proceeding under the Bankruptcy Code in which a creditor has a lien or security interest on or in property that the debtor intends to use under its Chapter 11 or Chapter 13 plan. The Ninth Circuit's opinion, which requires the debtor to pay a premium on secured claims under 11 U.S.C. § 506 to allow the secured creditor to "benefit" from the alleged "risk" it runs under the plan, will hinder many debtors in their attempts to successfully reorganize and get a fresh start. The Ninth Circuit's opinion also ignores the fact that any "risk" run by a creditor is compensated by the fact that every secured creditor retains its lien to the extent of its allowed secured claim and that it is paid interest on its allowed secured claim to the extent payment of that claim is deferred. 11 U.S.C. § 1129(b)(2)(A)(i).

The conflict between the decision of the Ninth Circuit and that of the Fifth Circuit also means that presently an important provision of the bankruptcy laws is not uniformly applied. As this Court has recognized, such a conflict necessitates that the writ be granted. See, Dewsnup v. Timm, 502 U.S. 410, 414 (1992).

B. The Ninth Circuit Adopted an Inflexible Rule for Applying § 506(a) in Chapter 11 Cases Contrary to Congressional Intent and Legislative History

This Court has examined other subsections of § 506 on several occasions, in the process setting forth rules to construe the statute's meaning. Dewsnup v. Timm, 502 U.S. 410 (1992); United States v. Ron Pair Enterprises, 489 U.S. 235 (1989). First, the Court looks to the language of the statute. If the language is plain, this is "where the inquiry should end" since the Court's "sole function" is to apply the statute as it reads. Ron Pair Enterprises, supra, 489 U.S. at 241. If the language is ambiguous, the court is to interpret the statute in light of its legislative history and the "slate" of pre-Code practice. Absent legislative history that indicates Congressional intent "to effect a major change in pre-Code practice," the statute is to be interpreted in light of such practice. Dewsnup, supra, 502 U.S. at 419.

As recognized by the Fifth Circuit in Rash, 90 F.3d at 1042ff, § 506(a) can be parsed into two portions. First, an allowed claim is secured to the extent of "the value of such creditor's interest in such property." Second, that valuation is to be made "in light of the purpose of the valuation and of the proposed disposition or use of such property... ."

The statute thus requires the Court to determine the value of two interests in the property, namely, the estate's interest in the property and, second, the creditor's interest in the estate's interest. This has to be done in light of the facts and circumstances of the case. House Report No. 995-595, 95th Cong. 1st Sess., stressed this point:

> "Value" does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.

In its analysis, the Ninth Circuit ignored both the need to value the IRS's interest in the estate's interest in the property and that the valuation was for purposes of determining the amount of deferred cash payments to the IRS under the "cram down" provisions of § 1129(b)(2)(A)(i). That section states that as to secured claims a plan may provide:

> (i)(I) that the holders of such claims retain the liens securing such claim, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of

> such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

The valuation of the estate's interest in the property begins by determining the property's value, based on its intended use. If this use is the property's "highest and best use," that value would be fair market value.[2] Next, the court must determine the extent of the estate's interest in the property. If the estate has a fee interest, the value of that interest would be equal to the valuation of the property.

Next, the court must value the creditor's secured interest. Like valuing the estate's interest, this involves several steps. First, a determination must be made of the equity to which the lien or interest attaches. This is the maximum value of the secured claim. Second, a determination must be made regarding the nature of the creditor's interest. This requires an analysis of the creditor's rights in the collateral, see, e.g.,

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[2] Congress has authorized the valuation of property based on its actual or intended use, rather than its highest and best use, in circumstances other than reorganization proceedings to avoid economic hardship to the owners while encouraging the owner's continuation of an ongoing business. See, e.g., 26 U.S.C. § 2032A (allowing valuation for estate taxes of real property used in farming or a business to be valued based on its actual use rather than its highest and best use).

Nobleman v. American Savings Bank, 508 U.S. 324 (1993), and of how those rights affect the "value" of the creditor's interest in the collateral. The process is similar to determining what a third party at arm's length would pay to acquire the secured creditor's rights and interest if the bankruptcy had not intervened.

The Ninth Circuit in the instant case performed only the first step: determining the maximum equity to which the IRS' lien attached. It did not and, indeed, refused to perform the second and crucial step of the valuation process: determining the nature and value of the IRS's interest in the estate's interest in the residence.

Unlike a mortgagee, who is entitled to an income stream from the property, the right to accelerate the note upon default, and the right to seize and sell the property, the IRS' rights against the property are (a) to be paid the proceeds of a sale after payment of costs and senior liens; (b) to levy; and (c) to redeem if a senior lienholder forecloses. The IRS recognizes that the value of its lien is less than the property's net equity. See, IRM 57(10)(13).91.

The Ninth Circuit's inflexible approach to valuation in reorganization proceedings where the debtor intends to use the property appears based on the groundless belief that otherwise the secured creditor is not compensated for the "risk" forced upon it by the plan. The Ninth Circuit's approach ignores the fact that the Bankruptcy Code provides two forms of compensation to a creditor who receives deferred cash payments: a lien against the collateral equal to the allowed

amount of the claim and, second, interest on the amount of the secured claim until that claim is paid in full.

The Ninth Circuit's approach also does not distinguish between different types of liens and security interests. There are numerous different types of liens and security interests: judgment liens, tax liens, security interests under the Uniform Commercial Code, charging orders, notes secured by deeds of trust, and notes secured by deeds of trust and assignments of rents, to name a few. Each one of these types of liens or interests could have characteristics which make that lien or interest more or less valuable. A characteristic which allows the creditor to obtain a greater amount of money from the collateral makes the lien or interest more valuable, while a characteristic which limits the ability of a creditor to obtain money from the collateral makes the lien or interest less valuable. Hence the relevance of determining what the creditor would receive if the creditor disposed of the collateral in a commercially reasonable manner.

Finally, the Ninth Circuit's approach ignores the alternative method to deferred cash payments a debtor may elect under § 1129(b)(A)(iii)-- "the realization by such holders of the indubitable equivalent of such claims." The legislative analysis that accompanied the House of Representatives Bill which ultimately became the Bankruptcy Reform Act of 1978, H.R. 8200, stated with regard to this provision: "Abandonment of the collateral to the creditor would clearly satisfy indubitable equivalence, as would a lien on similar collateral." Had the Taffis abandoned the property to the IRS under the plan, the property would have been sold by levy and the IRS would have

received the proceeds after payment of senior liens and sale costs. This amount is the value of the IRS' secured claim.

As recognized by the Fifth Circuit in Rash, the language of § 506(a) in the context of the reorganization cram-down provisions, the Legislative history of § 506(a), and the economic relationship of the debtor and the secured creditor militate against adoption of the Ninth Circuit's inflexible rule. To resolve the conflict between the Ninth Circuit and the Fifth Circuit and to ensure that § 506(a) is applied in reorganization proceedings in a manner consistent with the statute's language, history and the economic relationship of the parties, this Court should grant the writ.

CONCLUSION

Based on the foregoing, Petitioners Donald Taffi and Madelaine Taffi pray that this Court grant a writ of certiorari to review the decision of the Court of Appeals for the Ninth Circuit.

DATED: October 25, 1996 Respectfully submitted,

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App. 1

In re Donald TAFFI; Madelaine TAFFI, Debtors.
Donald TAFFI; Madelaine TAFFI, Plaintiffs-Appellants,

v.

UNITED STATES of America, Defendant-Appellee.

Nos. 94-55011, 94-55019.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted Aug. 15, 1996.
Decided Sept. 17, 1996.

Appeals from the United States District Court for the Central District of California Mariana R. Pfaelzer, District Judge, Presiding

Before: HUG, Jr., BEEZER, HALL, BRUNETTI, NOONAN, Jr., THOMPSON, LEAVY, TROTT, RYMER, NELSON and THOMAS, Circuit Judges.

NOONAN, Circuit Judge.

Donald and Madelaine TAFFI appeal the judgment of the district court as to the value to be placed on a residence retained by them as debtors in a proceeding under Chapter 11 of the Bankruptcy Code. At issue is the proper construction in this context of 11 U.S.C. § 506(a). The district court valued the residence at its fair market value. We affirm the judgment of the district court, except that we reduce the amount of the government's tax lien to its allowed secured claim.

FACTS

The TAFFIS owe the Internal Revenue Service (the IRS) $496,940 for tax liability that arose in 1980 and 1981. To secure payment of this claim, the IRS on October 12, 1989 attached a tax lien to the TAFFIS' personal residence (the House) and recorded it. The IRS also recorded a lien on the personal property of the TAFFIS in the amount of $10,000. Senior liens in the amount of $233,942.38 already encumbered the House.

The parties stipulated that the fair market value of the House was $300,000.00. That value represented what a willing and fully informed buyer would pay under fair market conditions. The parties also stipulated that the costs of selling the House in the marketplace would be nine percent, or $27,000.00. Taking into account the senior liens, the IRS would thus secure by the House $66,057.62, or, if hypothetical costs of sale were deducted, $39,057.62. The parties further stipulated that the House would sell for only $240,000.00 under forced sale conditions. That amount was the foreclosure value of the House. Under the forced sale scenario, the IRS would secure by the House only $6,057.62 after taking into account the senior liens, and nothing if costs of sale were deducted.

PROCEEDINGS

On May 22, 1991 the TAFFIS sought relief under Chapter 11 and proposed a plan of reorganization (the Plan). On February 27, 1992 the court approved the Plan, by which, inter alia, the TAFFIS provided for the treatment of the tax liens of the IRS. No objection was made to the Plan, and the order confirming the Plan became final. There remained in dispute between the TAFFIS and the IRS the valuation of the IRS's interest in the House.

On August 17, 1992, the bankruptcy court entered judgment in this case. Guided by *In re Mitchell*, 954 F.2d 557 (9th Cir.), cert. denied, 506 U.S. 908, 113 S.Ct. 303, 121 L.Ed.2d 226 (1992), the bankruptcy court held that the foreclosure value was the proper value to be placed upon the property. The bankruptcy court reached its conclusion as a matter of stare decisis even though "the *Mitchell* court's interpretation appears faulty on the facts and in view of the plain language of 11 U.S.C. § 506(a)." The court concluded that the IRS had an allowed secured claim in an amount equal to the foreclosure value of the House plus the value of the personal property ($240,000 + $10,000 = $250,000), less the senior liens of $233,942.38, resulting in a total secured claim of $16,057.62. The IRS also had an allowed unsecured claim in the amount of $480,881.38. The court held that the tax lien was not void but that the unsecured portion of the IRS claim, under operation of the Plan, would be satisfied by payment of a fraction of the claim.

The United States appealed to the District Court for the Central District of California. The TAFFIS filed a cross-appeal. On October 6, 1993 the district court held in favor of the government: under Section 506(a) the House should be valued at the market value. The court also held that the valuation was not affected by the hypothetical cost of sale so that the sales cost should not be deducted from the value. The total secured claim of the IRS came to an amount equal to the market value of the House plus the value of the personal property ($300,000 + $10,000 = $310,000), less the senior liens of $233,942.38, resulting in a total secured claim of $76,057.62. The court further held that the IRS could not be forced to release its lien as to the unsecured portion and held that the tax liens "passed through the bankruptcy regardless of what the provisions of the plan purported to accomplish."

The TAFFIS appealed to this court. On October 10, 1995 a divided panel upheld the judgment of the district court, distinguishing *Mitchell* as a case involving the wholesale value and retail value of an automobile, not a house, and noting that "the terms 'wholesale' and 'retail' represent two different fair market values for an automobile", while the forced sale value of a residence "does not represent a fair market value at all." The court also agreed with the district court that the hypothetical cost of the sale should not be deducted from the fair market value. Finally, the government conceded that the Plan of reorganization "served to reduce the lien, and that the Plan was binding on the IRS." As the IRS had not objected to confirmation of the Plan, its lien had to be reduced to the amount of its secured claim.

This court then took the case en banc.

ANALYSIS

A single question is presented to the en banc court: what is the appropriate method of valuation prescribed in a reorganization under Chapter 11 where collateral is retained by the debtors for the debtors' use? The Bankruptcy Code provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction

with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a).

The "property" of the estate of the debtor is the House. The "interest of the estate" is the ownership and possession of the House. The "interest of the creditor" is the tax lien on the House. According to the second sentence of section 506(a), that valuation is to be done variously depending on the context, in light of two factors, the purpose of the valuation and the use or disposition to be made of the interest.

When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. Instead, when the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive for the debtor's continued possession. Hypothetical sales costs are not to be considered because no sale is intended.

In this case, the key fact is that the debtors are going to possess the House. This fact determines the disposition and use of the creditor's interest. The foreclosure value is not relevant because no foreclosure is intended by the Plan. The TAFFIS are in, not outside of, bankruptcy. The IRS is not foreclosing. Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using.

The fair market value is not "replacement value" because the House is not being replaced. The fair market value is the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon after the property has been exposed to the market for a reasonable time. The fair market value here has been determined by stipulation of the parties, approved by the bankruptcy court, to be $300,000.

There is nothing inequitable in this result. By agreeing to the Plan and allowing the TAFFIS to retain their residence, the IRS runs a risk. It is appropriate that it also benefit from the higher valuation. See In the Matter of Rash, 90 F.3d 1036, 1066 (5th Cir.1996) (dissent).

We overrule In re *Mitchell*, 954 F.2d 557 (9th Cir.1992), to the extent that it held the valuation under section 506(a) should be based on determining "what the creditor would obtain if the creditor were to make a reasonable disposition of the collateral." Id. at 560. We make no judgment whether the fair market value of an automobile is high blue book or low blue book or some other value; that value is to be determined by the facts presented to the bankruptcy court.

Reaching this result, we put this circuit in harmony with all other circuits, except the Fifth, that have considered the question, *In re Trimble*, 50 F.3d 530, 531-2 (8th Cir.1995); *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72, 75-76 (1st Cir.1995); *In re McClurkin*, 31 F.3d 401, 405 (6th Cir.1994); *In re Coker*, 973 F.2d 258, 260 (4th Cir.1992).

Accordingly, the judgment of the district court is AFFIRMED with the modification that the IRS's concession as to the reduction of the tax lien is to be incorporated into the judgment.

Counsel Listing

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Gary R. Allen, Gary D. Gray, Paula K. Speck, United States Department of Justice, Washington, D.C. for the defendant-appellee.

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In re DONALD TAFFI; MADELAINE TAFFI, *Debtors.*	Nos. 94-55011 94-55019
DONALD TAFFI; MADELAINE TAFFI, *Plaintiffs-Appellants,* v. UNITED STATES OF AMERICA, *Defendant-Appellee.*	D.C. Nos. CV-92-06665-MRP CV-93-01800-MRP OPINION

Appeals from the United States District Court
for the Central District of California
Mariana R. Pfaelzer, District Judge, Presiding

Argued and Submitted
June 7, 1995—Pasadena, California

Filed October 10, 1995

Before: J. Clifford Wallace, Chief Judge, Alex Kozinski and Pamela Ann Rymer, Circuit Judges.

Opinion by Chief Judge Wallace;
Dissent by Judge Kozinski

SUMMARY

Bankruptcy/Claims/Real Estate

The court of appeals affirmed in part a district court judgment, reversed in part, and remanded. The court held that the

residence of a bankruptcy debtor should be valued, for purposes of determining the amount of a secured claim, at the residence's "fair market" value when the debtor is to keep possession of the residence, and "hypothetical costs of sale" are not to be subtracted from the valuation of the residence when determining the amount of the secured claim.

Appellants Donald and Madelaine Taffi filed a Chapter 11 bankruptcy petition. The Internal Revenue Service (IRS) and the California Franchise Tax Board, both of which had assessed the Taffis for taxes due, filed tax lien notices for the deficiency. The Taffis owned a residence.

The bankruptcy court confirmed the plan of reorganization, and the IRS did not object to the plan. The plan provided for release of all liens upon payment of the secured claim. The bankruptcy court determined that the value of the IRS's secured claim should be based on the forced sale value of the Taffis' residence. The court also concluded that the unsecured portion of the IRS tax lien was to be eliminated.

The district court reversed, holding that the IRS's secured claim should be valued based on the stipulated fair market value of the Taffis' residence. The court also denied the Taffis' request for a reduction based on hypothetical costs of sale. The court further concluded that the unsecured portion of the IRS's lien "passed through" bankruptcy unaffected by the plan. The Taffis appealed.

[1] Under 11 U.S.C. § 506(a), an allowed claim of a creditor secured by a lien on property in which the estate has an interest is secured to the extent of the value of the "creditor's interest" in the estate's interest in the property, and such value is to be determined "in light of the purpose of the valuation" and the "proposed disposition or use of" the property. [2] The several circuits which have considered the issue have concluded that the fair market value is the proper measure of value when a debtor retains possession of a residence. The

reasoning of the cases from those circuits was persuasive. A debtor who retains possession of a residence might eventually sell the residence. [3] In addition, legislative history indicates that "value" does not necessarily contemplate collateral's forced sale or liquidation value, and that courts must determine value on a case-by-case basis. [4] An earlier Ninth Circuit case, in which it was determined that the "wholesale" value was the best approximation of a creditor's interest in an automobile, was not to be extended to the facts of this case. The fair market value best approximated the IRS's interest in this case.

[5] A growing number of circuits which have considered the issue have all concluded that the hypothetical costs of sale should not be deducted. [6] Where a debtor retains possession of a residence, hypothetical costs of sale should not be deducted when fixing the amount of the allowed secured claim.

[7] The IRS's failure to object to the plan's confirmation warranted reducing its tax lien to the amount of its allowed secured claim.

Circuit Judge Kozinski dissented, writing that the majority's interpretation of § 506(a) was foreclosed by the Ninth Circuit's earlier opinion in *In re Mitchell.*

COUNSEL

A. Lavar Taylor, Santa Ana, California, for the plaintiffs-appellants.

Paula K. Speck, United States Department of Justice, Tax Division, Washington, D.C., for the defendant-appellee.

OPINION

WALLACE, Chief Judge:

The Taffis (Debtors) appeal from the district court's judgment in favor of the Internal Revenue Service (IRS). The district court held that for purposes of valuing a secured tax lien on the residence the Debtors will retain, the residence should be valued at its "fair market" value and that "hypothetical costs of sale" should not be deducted. The district court also refused to eliminate the unsecured portion of the IRS's lien upon confirmation of the Debtors' reorganization plan. We have jurisdiction over this timely appeal pursuant to 28 U.S.C. §§ 158(d), 1291. We affirm the district court's valuation of the lien, but reverse and remand for the limited purpose of having the district court reduce the amount of the IRS's tax lien to its allowed secured claim.

I

This case requires us to address two issues of first impression in this circuit. The first is whether the residence of a debtor should be valued, for purposes of determining the amount of a secured claim, at that residence's "fair market" value or "forced sale" value, when the debtor is to keep possession of the residence. The second issue is whether "hypothetical costs of sale" are to be subtracted from the valuation of the residence when determining the amount of the secured claim.

Debtors filed a Chapter 11 bankruptcy petition on May 22, 1991. The petition was filed because the IRS and the California Franchise Tax Board (FTB) had assessed the Debtors for taxes due in the amount, respectively, of $490,940.00 and $89,940.00. Both the IRS and the FTB filed tax lien notices for the deficiency. Debtors' personal property was worth about $10,000.00. Debtors did own a residence, but it was

encumbered with four deeds of trust totaling $233,942.38, all senior to the IRS and FTB liens.

It was stipulated that the fair market value of the residence was $300,000.00. That value represented what a willing and fully-informed buyer would pay under fair market conditions. It was also stipulated that the hypothetical costs of selling the residence in the marketplace would be nine percent, or $27,000.00. Taking into account the senior liens, the IRS would thus receive $66,057.62, or, if hypothetical costs of sale are deducted, $39,057.62. It was further stipulated that the residence would sell for only $240,000.00 under forced sale conditions. Thus, under the forced sale scenario, the IRS would receive only $6,058.62, after taking into account the senior liens and nothing if hypothetical costs of sale are deducted.

The bankruptcy court confirmed the plan of reorganization on February 27, 1992. The IRS did not object to the plan or the order confirming the plan. Because the IRS's lien was senior to the FTB lien, the entire FTB lien was unsecured and thus, under the plan, void. In a published opinion, the bankruptcy court determined that the value of the IRS's secured claim should be based on the forced sale value of the Debtors' residence. *Taffi v. United States*, 144 B.R. 105 (Bankr. C.D. Cal. 1992). Having determined that the proper valuation of the IRS's secured claim was based on the forced sale value, the bankruptcy court did not address whether any hypothetical costs of sale should be subtracted. The bankruptcy court also concluded that the unsecured portion of the IRS tax lien was to be eliminated in accordance with the plan, which provided for a release of "any and all liens" upon payment of the secured claim.

The district court reversed the bankruptcy court, holding that the IRS's secured claim should be valued based on the stipulated fair market value of the Debtors' residence. The district court also denied the Debtors' request for a reduction

based on hypothetical costs of sale. The court further concluded that the unsecured portion of the IRS's lien "passed through" bankruptcy unaffected by the reorganization plan. For this conclusion, the district court relied on *Dewsnup v. Timm*, 502 U.S. 410 (1992) (11 U.S.C. § 504(d), which provides that a lien is void "[t]o the extent that [it] secures a claim against the debtor that is not an allowed secured claim," does not allow a Chapter 7 debtor to "strip down" a creditor's undersecured lien to the judicially determined value of the collateral).

II

[1] The first issue we address is whether the fair market or forced sale value of the Debtors' residence should be used to determine the amount of the IRS's secured claim. To value a secured claim, we must look to 11 U.S.C. § 506(a), which provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . . Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property."

Several courts have pointed out a potential source of tension in section 506(a). On the one hand, the court is to obtain the value of the "creditor's interest." On the other hand, the "purpose of the valuation" and the "proposed disposition or use" of the property is also to be taken into account. *See In re Trimble*, 50 F.3d 530, 531 (8th Cir. 1995) (*Trimble*) (discussing how courts have "placed varying importance on [section 506(a)'s] two clauses, resulting in disagreement as to the proper valuation method of a creditor's secured claim").

If we focus solely on the "creditor's interest" in the property, it is tempting to say that that interest is always the amount of money that the property would bring based on a forced sale on the date of the approved plan. After all, a credi-

tor, in order to obtain any value from a secured asset that continues to be used by a debtor, ordinarily must sell it.

[2] However, the several circuits which have considered this issue have all concluded that the fair market value is the proper measure of value when a debtor retains possession of a residence. *See In re Winthrop Old Farm Nurseries*, 50 F.3d 72, 74 (1st Cir. 1995) (*Winthrop*) (concluding that the fair market value is the proper standard of valuation where a debtor retains property); *In re Rash*, 31 F.3d 325, 329 (5th Cir. 1994) (*Rash*) ("If the debtor retains the property as part of a reorganization, the proper measurement of the estate's interest in the property is the 'going-concern' value of the collateral to the debtor's reorganization."); *see also Trimble*, 50 F.3d at 532 (concluding that the retail value of the collateral is to be used when a debtor retains possession). The reasoning of these cases is persuasive. A debtor who retains possession of a residence might eventually sell it. If so, the secured claims would have to be paid off. But there is no reason to reduce the amount of an already undersecured claim to the forced sale value of the property at the time of the plan's approval, when no forced sale is contemplated. Doing so decreases the creditor's already devalued interest in the property. It is true that the property might have to be sold for the creditor to obtain satisfaction of the secured claim, but where no sale — much less a forced sale — is contemplated, reducing the creditor's lien in the way Debtors suggest would only serve to allow a debtor to capture any future equity in the property at the creditor's expense.

[3] In addition, the legislative history of section 506(a) indicates that: " 'Value' does not necessarily contemplate forced sale or liquidation value of collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6312. Subsection

506(a) "makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property." *See* S. Rep. No. 989, 95th Cong., 1st Sess. 68, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854.

Furthermore, with all of our sister circuits who have considered the issue arriving at the same conclusion, our going a different direction would only create an unnecessary intercircuit conflict. It is for this reason that we have adopted a cautionary rule, counseling against creating intercircuit conflicts. *See United States v. Chavez-Vernaza*, 844 F.2d 1368, 1374 (9th Cir. 1987) (*Chavez-Vernaza*), *cert. denied*, 114 S. Ct. 1324 (1994).

Debtors point to *In re Mitchell*, 954 F.2d 557 (9th Cir.), *cert. denied*, 113 S. Ct. 303 (1992), for contrary authority in this circuit. In *Mitchell*, the assignee of an automobile seller who had financed the debtor's automobile purchase filed a claim as a secured creditor in the debtor's chapter 13 case. The bankruptcy court valued the secured claim based on the retail value of the automobile. We reversed, holding that the wholesale value, rather than the retail value, generally should apply. This was so even though the debtor was keeping the car. *Id.* at 560. *Mitchell* reasoned that "what is being valued is the creditor's interest in the collateral, not the debtor's interest." *Id.* (internal quotation omitted). The wholesale price "best approximates this value." *Id.*

Debtors press an argument by way of analogy. They suggest that here, as in *Mitchell*, there are two standards, one equivalent to the retail value and one equivalent to the wholesale value. Debtors then read *Mitchell* for the proposition that the value of a non-income producing asset must be valued at the amount the creditor would obtain if the creditor were to make a reasonable disposition of the collateral.

[4] We will not extend *Mitchell* to the facts of this case with a resulting intercircuit conflict. *Mitchell* determined that

the wholesale value was the best approximation of a creditor's interest in an automobile. The wholesale value and retail value of an automobile are not the same as the fair market value and forced sale value of a residence. Neither a wholesale nor retail sale is "forced." Rather, the terms "wholesale" and "retail" represent two different fair market values for an automobile. The forced sale value of a residence, by contrast, does not represent a fair market value at all. The fact that the wholesale value is less than the retail value does not indicate that either are the product of anything other than "arms length" transactions involving rational, informed, and willing parties. There is nothing "forced" about either transaction. The Debtors in this case do not explain why the fair market value of their residence, as opposed to the forced sale value, is not the best approximation of the creditor's interest, given that under the plan the property will not be sold at a forced sale. The wholesale value of an automobile might be the best approximation of a creditor's interest in that automobile, but that tells us nothing about what value best approximates the IRS's interest in this case. In our view, it is the fair market value.

III

Having determined that the fair market value is the proper standard of valuation here, we must next decide whether hypothetical costs of sale should be subtracted from the amount of the IRS's allowed secured claim. The costs are hypothetical because the residence is not being sold.

[5] The growing number of circuits to have considered this issue have all concluded that hypothetical costs of sale should not be deducted. *See Trimble*, 50 F.3d at 532 (no reduction of secured claim based on hypothetical costs of sale when debtor retains possession of property) (8th Cir.); *Winthrop*, 50 F.3d at 74 (same) (1st Cir.); *In re McClurkin*, 31 F.3d 401, 405 (6th Cir. 1994) (*McClurkin*) (same); *Rash*, 31 F.3d at 329 (same)

(5th Cir.); *In re Balbus*, 933 F.2d 246, 252 (4th Cir. 1991) (same).

As the Sixth Circuit has explained:

> The automatic deduction for "costs of sale" . . . proceeds . . . from the erroneous assumption that a secured creditor "receives" only the net proceeds from the disposition of the collateral. When a creditor forecloses on the property . . . the creditor "receives" *all* of the proceeds of the sale. . . . There is no basis . . . for assuming that the costs of sale are paid with the "first dollar" of the sale proceeds rather than being added to the debtor's deficiency.
>
> The idea of limiting a creditor's "interest" in the collateral to the hypothetical "net" sale proceeds appears also to have been influenced by the Bankruptcy Code's treatment of *over*secured creditors. Under § 506(b), an oversecured creditor . . . has a secured claim . . . to the extent of the *net* sales proceeds. *See* § 506(c). The treatment of *over*secured creditors, however, is not relevant to determining, and provides no basis for limiting, the *under*secured creditor's interest in the collateral.

McClurkin, 31 F.3d at 405 (emphasis in original).

Furthermore, we have concluded once before that it is inappropriate to deduct hypothetical costs of sale from the amount of a secured claim when the debtor retains possession of a residence. *See Lomas Mortgage USA v. Wiese*, 980 F.2d 1279, 1285 (9th Cir. 1992), *vacated on other grounds*, 113 S. Ct 2925 (1993). Although *Lomas* does not bind us, we conclude that its analysis of the issue is persuasive and adopt it. Having once arrived at what we still perceive to be the better rule which was not affected by the Supreme Court's vacatur, it is especially important not to reverse ourselves and create an

intercircuit conflict. *See Chavez-Vernaza*, 844 F.2d at 1374; *Orhorhaghe v. INS*, 38 F.3d 488, 493 n.4 (9th Cir. 1994) (vacated opinion is persuasive authority if sound).

[6] Nor does *Mitchell* affect our decision on this issue either. *Mitchell*, as discussed earlier, held only that the wholesale rather than retail value of an automobile was the proper standard to use when fixing the value of a lien on an automobile. Both retail and wholesale prices might contain costs of sale. *Mitchell* did not address whether such costs should be deducted when the debtor retained the automobile. We therefore reaffirm our analysis in *Lomas* and join our sister circuits in holding that where a debtor retains possession of a residence, hypothetical costs of sale should not be deducted when fixing the amount of the allowed secured claim.

IV

[7] Finally, the district court concluded that the IRS's lien should not be reduced to the amount of its allowed secured claim. The court relied on *Dewsnup* for the proposition that the unsecured portion of the IRS's lien could "pass through" bankruptcy unaffected. Regardless of the applicability of *Dewsnup* to a chapter 11 proceeding, the IRS concedes on appeal that the plan of reorganization served to reduce the lien, and that the plan was binding on the IRS. *See* 11 U.S.C. § 1141(c) (confirmed plan binds "all claims and interests of creditors"). Having failed to object to the confirmation of the plan, the IRS's tax lien should be reduced to the amount of its allowed secured claim. *See Lawrence Tractor Co. v. Gregory*, 705 F.2d 1118, 1121 (9th Cir. 1983) (failure to object to plan precludes collateral attack of plan provision). Therefore, the district court, on remand, is to reduce the amount of the IRS lien to reflect only the amount of the allowed secured claim based on the fair market value of the residence without a reduction for hypothetical costs of sale.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

KOZINSKI, Circuit Judge, dissenting:

1. My colleagues adopt a plausible interpretation of 11 U.S.C. § 506(a), but one foreclosed by our earlier opinion in *In re Mitchell,* 954 F.2d 557 (9th Cir. 1992). The majority's attempt to distinguish *Mitchell* is unconvincing. The question in *Mitchell* was how to value a security interest in a car. *Mitchell* answered that the "creditor's interest" is "what the creditor would obtain if the creditor were to make a reasonable disposition of the collateral." *Id.* at 560. *Mitchell* rejected the alternate value suggested by the creditor, namely the "replacement cost to the debtor." *Id.*

It's true that *Mitchell* referred to the two values as "wholesale" and "retail," but that was merely a shorthand. *Mitchell* made it clear that by "retail value" it meant the value of the car in the hands of the debtor, and by "wholesale value" it meant what the car would bring the creditor on foreclosure. It chose the wholesale price, not because it was the "fair market value," *cf.* Maj. op. at 13197, but because, it "appear[ed] to . . . best approximate[ ]" the creditor's collection value. *Mitchell,* 954 F.2d at 560.

Mitchell construed the same section of the Bankruptcy Code as we, and it rejected exactly the same approach we accept today: In *Mitchell,* as in our case, "[t]he use of the property [was] to be by the debtor." *Id.* at 559-60. The creditor argued, as does the Commissioner here, that "since the debtor intends to use the [property], the value of the creditor's secured interest should be based upon the replacement cost to the debtor." *Compare id.* at 560, *with* Appellee's Br. at 16-17 (advocating "the price at which the property would change hands between a willing buyer and a willing seller" because "debtor intends to retain the property").

Mitchell reached its conclusion over a vigorous dissent. Like the majority today, Judge Noonan protested that the debtor would retain possession and therefore "the cost of pro-

viding a similar car" (replacement value) was the only appropriate valuation method under the second sentence of section 506(a). 954 F.2d at 561. The *Mitchell* majority rejected this approach because it values the asset in the hands of the debtor and therefore "ignores the clause of the statute that defines the value of the secured claim as the value of the 'creditor's interest' in the property." *Id.* at 560 (citing James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 Com. L.J. 18, 30 (1987)).

Mitchell leaves open the possibility of taking the debtor's use of the property into account where it's part of a going concern, or where use by the debtor is either "particularly beneficial" or "particularly detrimental." *Id.* In the ordinary case, however, it holds that the proper valuation is what the creditor would get if it foreclosed on the collateral.

The majority makes much of the fact that the parties here identified what the IRS could get for the property as the "forced sale" value. In my colleagues' view, this distinguishes our case from *Mitchell* because a "forced sale" doesn't yield a "market value." Maj. op. at 13197. I don't see the point. Section 506(a) doesn't call for "market value;" the majority pulls that term out of thin air. The statute calls for a determination of the "creditor's interest" in the property. Quite often, what the creditor realizes from the collateral is *not* the market value. This depends a great deal on the type of asset and the nature of the security interest. In *Mitchell*, the asset was a car; the relevant valuation terms were "retail" and "wholesale" because cars, unlike real estate, may be repossessed by the creditor and sold "at wholesale or retail and at any time and place and on any terms, provided the secured party acts in good faith and in a commercially reasonable manner," Cal. Com. Code § 9504(3). A security interest in real estate, by contrast, can normally be realized only by some sort of forced sale. *See, e.g.*, Harry D. Miller & Marvin B. Starr, *Current Law of California Real Estate* §§ 9:121 *et seq.* (power of sale under a deed of trust), §§ 9:161 *et seq.* (judicial sale) (2d ed.

1989); 26 U.S.C. §§ 6331, 6335 (auction after tax seizure). Applying *Mitchell*, the Commissioner's interest in the real estate here is its forced sale value, which is what she could reasonably hope to collect from enforcing her lien.

Were the matter not otherwise clear, one could examine the cases on which the majority relies. All three draw a sharp distinction between the foreclosure or hypothetical sale value (which they reject) and the retained value to the debtor (which they adopt). *See In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72 (1st Cir. 1995); *In re Trimble*, 50 F.3d 530, 531 (8th Cir. 1995); *In re Rash*, 31 F.3d 325, 328-29 (1994), *modified*, No. 93-5396, 1995 WL 489072 (5th Cir. Aug. 15, 1995). This is precisely the division between the majority and the dissent in *Mitchell*. Indeed, *Rash* and *Trimble* specifically mention *Mitchell* and *reject* it. *Rash* goes so far as to rely on Judge Noonan's dissent: "The 'estate's interest in the property' is the ownership and possession of vehicle by the debtor, *see Mitchell*, 954 F.2d at 561 (Noonan, J., dissenting). . . ." 31 F.2d at 329. *Rash* and *Trimble*, which also involved motor vehicles, used the valuation nomenclature of *Mitchell*, referring to the values in question as wholesale and retail. *Winthrop* cites and rejects the Queenan article which the *Mitchell* majority follows. In short, it is quite impossible to read the cases the majority cites without concluding that they consciously rejected the Ninth Circuit's approach in *Mitchell*. I find it most peculiar for us to go chasing consistency with other circuits when those circuits have already declared themselves in conflict with us.

This is an area where consistency within the law of the circuit matters a great deal because valuation of assets is at the heart of most bankruptcy proceedings. After today, we'll have two separate valuation methods, one for cars and another for homes. How will parties trying to value a multitude of other assets — from aalii to zwieback — know which rule applies to them?

If my colleagues believe that *Mitchell* was wrongly decided, they can call for en banc. But to dismiss so lightly a prior opinion of this court that addresses the very question we confront today only gives aid and comfort to those who claim the Ninth Circuit cannot or will not maintain the integrity of its caselaw.

2. The majority also rejects the Taffis' alternative argument that the value of the IRS' lien should be diminished by the costs of a hypothetical sale that could yield such a value. Its decision not to deduct costs of sale follows from its erroneous resolution of the principal issue. Since the majority measures the IRS' security interest by the value of the property in the debtors' hands (rather than by what it would fetch on foreclosure) it would make no sense to deduct hypothetical costs of sale.

I'm concerned, however, that the majority writes too broadly, as it seems to reject consideration of the costs of sale in all cases, even those involving cars (or car-like assets) that presumably continue to be governed by *Mitchell*. *Mitchell*-like cases *do* contemplate a disposition of the collateral by the creditor; in those circumstances, it becomes relevant to ask what, if anything, the creditor would have to spend to realize on its security. The normal rule is that the costs of a foreclosure sale are paid from any excess proceeds after the secured debt is satisfied — in other words, from the debtor's equity. Cal. Com. Code § 9504(1)(a), (b). But where there is no debtor's equity, the costs of sale perforce are paid by the creditor. A simple example illustrates the point. If a creditor with a $1,000 lien on a car sells the collateral (at a cost of $100) for $1,500 to satisfy the debt, it will be entitled to take its full $1,000 from the proceeds and then deduct the costs of sale from the debtor's remaining $500. If the car brings in only $500, however, the creditor will have to pay the costs of sale out of its own pocket; the net proceeds from foreclosure would be only $400.

Whether the creditor's interest in property should be diminished by the hypothetical costs of sale, then, turns on whether the creditor is oversecured. If the creditor is oversecured in the amount of the sales costs, it will recover the full amount of its lien. If it's oversecured by a lesser amount, or is undersecured, the costs of sale will necessarily diminish what it will take in to satisfy its lien.

Because I disagree with the majority as to the valuation issue, I also come to a contrary conclusion as to the sales costs issue. Here, the IRS had a lien of almost $500,000 against the Taffis' house and personal property. The parties have stipulated that the house is worth no more than $300,000. After taking out senior liens, that leaves the Commissioner about $70,000, so the Commissioner is heavily undersecured. Were there a foreclosure sale, there would be no debtor's equity to cover the sales costs. Accordingly, under *Mitchell*, the Bankruptcy Court should have diminished the value of the IRS' interest by the stipulated $27,000 in sales costs.

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In re DONALD J. TAFFI and MADELAINE TAFFI,
Debtors.

DONALD J. TAFFI and MADELAINE TAFFI,
Plaintiffs,

v.

UNITED STATES OF AMERICA, and the
FRANCHISE TAX BOARD for the State of California,
Defendants.

UNITED STATES OF AMERICA,
Appellant and Cross-Appellee,

v.

DONALD J. TAFFI and MADELAINE TAFFI,
Appellees and Cross-Appellants.

Nos. CV 92-6665 MRP, CV 93-1800 MRP.
United States District Court
C.D. California
October 7, 1993

The United States of America filed a notice of Appeal with the Bankruptcy Court in these consolidated matters on October 13, 1992. Donald and Madelaine Taffi ("the Taffis") filed a Notice of Cross Appeal on October 22, 1992. The questions presented by appellant and cross-appellee United States of America ("Appellant") are: 1) whether the Bankruptcy Court erred in holding that the value of the secured claim of the Internal Revenue Service ("IRS") under § 506(a) of the Bankruptcy Code is based on the value of the creditor's interest in the real property in question after the deduction of hypothetical sales

costs (e.g., a discount for a hypothetical forced sale); 2) whether the Bankruptcy Court erred in holding that the value of the secured claim of the IRS under § 506(a) of the Bankruptcy Code is $16,058.62; and 3) whether the Bankruptcy Court erred in holding that upon consummation of the debtors' reorganization plan, the IRS was required to release its tax liens in accordance with the terms of the plan.

The questions presented by appellees and cross-appellants Donald and Madelaine Taffi ("Appellees") are: 1) whether the Bankruptcy Court erred in failing to hold that the confirmed plan of reorganization ("plan") reduced the IRS's liens to the amount of its allowed secured claim; 2) whether the Bankruptcy Court erred in failing to conclude that the operation of Bankruptcy Code § 506(d) by itself reduced the amount of the IRS's allowed secured claim; 3) whether the Bankruptcy Court erred when it failed to conclude that the terms of the confirmed plan reduced the amount of the IRS's tax liens to an amount equal to the amount of the IRS's allowed secured claim under Bankruptcy Code § 506(a); 4) whether the costs of selling the Taffis' residence should be subtracted from the gross sales price of the residence in the event appellee's residence is valued at its fair market value rather than its forced sale value.

FACTS

Donald and Madelaine Taffi filed a voluntary Chapter 11 bankruptcy petition on May 22, 1991.[1] The Taffis' bankruptcy filing was prompted by income tax assessments made against them by the IRS and the Franchise Tax Board ("FTB") for 1980 and 1981 income taxes following IRS audits. As of the date of

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[1] See Appellant's Excerpts of Record ("E.R.") at p. 34.

the bankruptcy petition, the IRS claimed a total of $496,948.05 and the FTB claimed a total of $89,941.46. Both the IRS and the FTB filed tax lien notices against the Taffis prior to the date of the petition.[2]

As of the date of the petition, the Taffis' personal property was of little value. The parties stipulated that all of the Taffis' property other than their residence had a value of $10,000.00.[3] The only significant asset owned by the Taffis was their residence, which was encumbered by four deeds of trust, all of which were senior to the tax liens of the IRS and FTB. The total amount of debt secured by these four deeds of trust was $233,942.38.[4]

Under their Chapter 11 plan, the Taffis intended to retain their residence rather than sell it. The parties agreed that the "forced sale value" of the Taffis' residence was $240,000. This represented the amount which the IRS would have received for the residence if it had seized and sold the property pursuant to the applicable provisions of the Internal Revenue Code (26 U.S.C. § 6331, et. seq.). Such a sale would have netted the IRS $6,058.62 after taking all senior liens into account.[5] However, had the residence been sold to a willing buyer under "normal market" conditions without the need for a "quick sale," the parties agreed that $300,000.00 in gross sales proceeds would have been realized from the residence. The costs of a

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[2] See E.R. at p. 35.

[3] See E.R. at p. 37.

[4] See E.R. at p. 36

[5] See E.R. at p. 38.

sale under normal market conditions would have been 9% of the proceeds, or $27,000.00. Thus, taking into account senior liens, such a sale would have generated $39,057.62 in proceeds for payment of the IRS.[6]

On February 27, 1992, the Bankruptcy Court confirmed the Taffis' Chapter 11 plan after proper disclosure, balloting, notice and hearing.[7] In relevant part, the plan provided that

> [u]ntil its secured claim is paid in full, the Internal Revenue Service shall retain its lien to the extent of its secured claim in accordance with 11 U.S.C. § 1129(B)(2). Upon full payment of its secured claim, the Internal Revenue Service shall release any and all liens securing the claim.

The plan defined a "secured claim" as an allowed secured claim within the meaning of Bankruptcy Code § 506(a).[8] The IRS has not objected to the plan or the order confirming the plan, and the order confirming the plan has not been appealed or challenged in any respect.[9] All parties agreed that the liens of the IRS were senior to the lien of the FTB.[10] The FTB and the Taffis agreed that the entire claim of the FTB was unsecured

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[6] See E.R. at p. 38.

[7] See E.R. at p. 166.

[8] See E.R. at p. 75.

[9] See E.R. at p. 166.

[10] See E.R. at p. 36; Supplemental Excerpts of Record of Taffis at p. 31 ("S.E.R.").

(i.e., that the allowed secured claim of the FTB was zero) and that the FTB's lien was void.[11]

The Bankruptcy Court was required to resolve two issues. First, it had to determine the amount of the IRS's "allowed secured claim" for purposes of Bankruptcy Code § 506(a). The Taffis contended that this amount should be equal to the value of their personal property plus the amount the IRS would receive on the disposition of their residence if it were sold at a forced sale. The IRS contended that the value of the IRS's interest in the residence should be determined by referring to the normal market sales price of the residence, without any adjustment for the costs associated with such a sale by the Taffis. The Taffis alternately contend that, if the court used the "normal market" sales price, the costs of selling the home should be subtracted from the sales price in determining the amount of the IRS's allowed secured claim.

The Bankruptcy Court, relying on the reasoning of In re Mitchell, 954 F.2d 557 (9th Cir. 1992), cert. denied, General Motors Acceptance Corp. v. Mitchell, 113 S. Ct. 303 (1992), concluded that the amount of the IRS's allowed secured claim should be that amount which the IRS would receive if the IRS sold the residence in what the Bankruptcy Court determined was the only reasonable manner available to the IRS-- a forced sale.[12]

The second issue considered by the Court was the effect of the proceedings in the Bankruptcy Court on the IRS's pre-bankruptcy liens. The Taffis argued that, by virtue of

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[11] See S.E.R. at p. 31.

[12] See E.R. at p. 169 - 174.

Bankruptcy Code § 506(d), the amount of the IRS's liens had been reduced to an amount equal to the IRS's allowed secured claim. Alternatively, the Taffis argued that the application of Bankruptcy Code § 506(d) was actually moot because the amount of the IRS's liens had already been reduced to the amount of the IRS's allowed secured claim under the provisions of the confirmed plan. The IRS contended that the IRS's liens were unaffected by either Bankruptcy Code § 506(d) of the provisions of the confirmed plan.

The Bankruptcy Code held that the IRS's liens were not affected by Bankruptcy Code § 506(d). As to the effect of the confirmed plan, the court did not hold that it operated to reduce the amount of the IRS's liens to the amount of the IRS's allowed secured claim, but it did hold that the IRS required to release its pre-bankruptcy liens upon consummation of the plan by the Taffis.[13]

DISCUSSION

A. Valuation of the Allowed Secured Claim

The valuation of a secured claim is governed by § 506(a) of the Bankruptcy Code. The first sentence of § 506(a) states in part that a claim is secured "to the extent of the value of such creditor's interest in the estate's interest in such property. . . ." The second sentence states that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . ."

The Bankruptcy Court relied on the Ninth Circuit case of In re Mitchell, 954 F.2d 557 (9th Cir. 1992), to interpret § 506(a).

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[13] See E.R. at p. 174 - 186.

The asset in question in Mitchell was an automobile, on which the creditor had a first lien. The parties disagreed over the proper method for determining the amount of the creditor's "allowed secured claim" under § 506(a) for purposes of paying that claim under the debtor's plan. The debtor argued that the appropriate method of determining the vehicle's value under § 506(a) was to look to the vehicle's wholesale "blue book" value. The creditor argued instead for the vehicle's retail "blue book" value. The Ninth Circuit agreed with the debtor, stating that under § 506(a), courts endeavor to "determine what the creditor would obtain if the creditor were to make a reasonable disposition of the collateral. It would appear to be the wholesale price which best approximates this value." 945 F.2d at 560. (Citation omitted.) Relying on the reasoning of Mitchell, the Bankruptcy Court ruled that the "forced sale" value of the Taffis' residence, not its "fair market" value, was the proper measure of the IRS's allowed secured claim under § 506(a).

This Court agrees with Appellant that the Bankruptcy court's reliance on Mitchell is misplaced. First, the facts of this case are distinguishable from those in Mitchell. The collateral to be valued in Mitchell was a used automobile, a highly depreciable consumer property. The Mitchell court held that since a creditor who had seized a used automobile could not sell it for its retail replacement value, the value of the creditor's secured claim in the automobile under § 506(a) should be the wholesale value of the automobile. Id. In reaching that result, the Mitchell court discussed the decision of the Bankruptcy Appellate Panel in In re Malody, 102 Bankr. 745, 749 (Bankr. 9th Cir. 1989), a case in which the asset involved was also a used automobile. In the case before this Court, the collateral to be valued is real property which is quite unlike the consumer property at issue in In re Malody and In re Mitchell, which had "little or no resale value," but "a high replacement cost." Id.

Second, Mitchell involved property which had both a wholesale and a retail value. Here, the Bankruptcy Court has itself recognized that "[h]ouses are not sold on a wholesale basis" and that there is not "`retail' value for a house."[14] Despite this fact however, the Bankruptcy Court apparently drew an analogy between the wholesale versus retail value of an automobile and the "forced sale" versus "fair market" value of a residence. The analogy is not apt. Appellants are correct in arguing that, in making a valuation under § 506(a), a distinction must be drawn between real property and highly depreciable consumer property such as automobiles, furniture, clothes and personal effects.

1. "Forced Sale" versus "Normal Market" Value

The Bankruptcy Court stated that a forced tax sale is "the only reasonable disposition that the IRS as a creditor can make of the House."[15] However, this conclusion, based on an assumption, fails to take into account that the Taffis did not intend to sell the residence, but were merely trying to value it under § 506(a). It is agreed that the Taffis intend to continue to use the house as their personal residence, and under those circumstances, it is inequitable to give the Taffis the benefit of the value the residence would bring at a "quick sale." In Lomas Mortgage, USA v. Wiese, 980 F.2d 1279 (9th Cir. 1992), the Ninth Circuit upheld the bifurcation of the creditor's claim into secured and unsecured portions. The court then addressed the issue of valuation under § 506(a). After noting that the legislative history of the statute is minimal, the court went on to

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[14] See Record at p. 172.

[15] See Record at p. 172.

note that the Senate Report "states only that '[w]hile courts will have to determine value on a case by case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property." Id. at 1282 quoting S. Rep. No. 989, 95th Cong. 2d Sess 68 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5854. where the debtors intend to retain and use the real property which is to be valued under § 506(a), courts have not looked to a "forced sale" standard, but instead have adopted a normal market value standard. See In re Coker, 973 F.2d 258, 259-60 (4th Cir. 1992); In re Case, 115 Bankr. 666, 669-70 (Bankr. 9th Cir. 1990). See also Collier on bankruptcy, 15th ed., ¶ 506.04 at 506-31 - 506-32 (1991 and 1992 Supp.). Furthermore, if the IRS had seized the Taffis' residence, it would not necessarily have been required to dispose of it quickly. As the IRS has noted, it could have held onto its liens and awaited a voluntary disposition of the property by the taxpayers. Consequently, it is unfair to the IRS to base the value of the secured claim on the assumption of a "forced sale." The "normal market" standard for valuation of the Taffis' residence gives meaning to both the last sentence of § 506(a) as well as the first. It is the correct standard to apply here.

2. Deduction of Costs of Sale

Because the Bankruptcy Court held that the "forced sale" value of the Taffis' residence was the correct standard of valuation of the IRS's interest, the Bankruptcy Court did not reach the question of whether the costs of sale should be deducted from the gross sales price in the event that the creditors' interest was based on the "fair market" value of the residence. In Lomas Mortgage, the Ninth Circuit sated "agreements between the creditor and third parties should not affect the valuation of the subject property" and that because the property would be retained by the debtor it would be

inappropriate to deduct the transaction costs from the fair market value. Id. at 1283-86. Consequently, the cost of the sale of the residence should not be deducted from the gross sales price of the residence. The total secured claim of the IRS is in the amount of $76,058.62.

B. Release of Tax Liens

To the extent that a creditor's lien secures the unsecured portion of the creditor's claim, the lien may not be voided under § 506(d). Whatever the debate may be about the reasoning of the opinion, in Dewsnup v. Timm, 112 S. Ct. 773 (1992), the Supreme Court held that liens pass through bankruptcy unaffected. Furthermore, Rule 7001(2) of the Federal Rules of Bankruptcy Procedure requires that an adversary proceeding be brought "to determine the validity, priority, or extent of a lien or other interest in property." When a plaintiff seeks to void or release a lien, the extent and validity of that lien must be determined through an adversary proceeding within the meaning of Rule 7001. See In re Commercial Western Finance Corp., 761 F.2d 1329, 1336 (9th Cir. 1985); In re Golden Plan of California, Inc., 829 F.2d 705, 711-12 (9th Cir. 1986). Consequently, under Supreme Court precedent and the Bankruptcy Code, a debtor cannot avoid a lien merely by operation of the provisions of a plan of reorganization.

The Bankruptcy Court recognized that the Taffis could not avoid the secured portion of the IRS liens through the confirmed plan of reorganization. The Bankruptcy Court also recognized that the IRS liens could not be voided under § 506(d). However, the Court accepted the Taffis' argument that "nothing in Dewsnup bars a Chapter 11, 12 or 13 proponent from dividing an undersecured claim into separate secured and unsecured claims" and satisfying them through confirmation and

consummation of a plan. Then, according to the Taffis, on consummation of the plan and payment of the secured portion of the claim, the lienholder could be required to release its lien. The difficulty with this application of non-bankruptcy law to force the IRS to release its liens is that in effect it allows the Taffis to avoid the IRS liens. This result is wholly inconsistent with the teaching of Dewsnup and thus contrary to established law. The ax liens of the IRS pass through the bankruptcy regardless of what the provisions of the plan purported to accomplish, and the IRS cannot be required to release its liens on payment of the secured portion of the liens and consummation of the plan.

The judgment of the Bankruptcy Court is reversed.

In re Donald & Madelaine TAFFI, Debtors.
Donald & Madelaine TAFFI, Plaintiffs,

v.

UNITED STATES of America, and the Franchise Tax Board for the State of California, Defendants.

Bankruptcy No. LA 91-76720-VZ.
Adv. No. LA 91-07518-VZ.

United States Bankruptcy Court, C.D. California.
Aug. 17, 1992.

Chapter 11 debtors filed adversary proceeding for judgment dividing Internal Revenue Service's (IRS) prepetition tax claim into secured and unsecured claims. On cross motions for summary judgment, the Bankruptcy Court, Vincent P. Zurzolo, J., held that: (1) in valuing secured portion of tax lien against debtors' house, disposition value, rather than fair market value, of house had to be used, and (2) tax lien was not void to extent it corresponded to unsecured portion of claim.

So ordered.

[1] COURTS k96(3)

Under the doctrine of stare decisis, federal courts, including Circuit Courts of Appeal, district courts and bankruptcy courts, are absolutely bound by decisions of Supreme Court on issues of law, even if in opinion of inferior court, Supreme Court has erred, or decision of Supreme Court was summary and not plenary.

[2] COURTS k96(4)

Under doctrine of stare decisis, decision of Court of Appeals is binding on all inferior courts in that circuit, even if split of opinion exists between controlling circuit and another Circuit Court of Appeals and inferior court believes that controlling circuit court is in error.

[3] STATUTES k218

When court construes statute, that construction is final and is deemed to become part of the statute, until or unless it is overturned by Congress, especially when court construes statute affecting rights in real property.

[4] BANKRUPTCY k2852

Value of lien creditor's interest in collateral that is property of bankruptcy estate must be determined after considering both purpose of valuation and proposed disposition or use of property. Bankr.Code, 11 U.S.C.A. § 506(a).

[5] COURTS k89

In applying doctrine of stare decisis to facts substantially different from those decided by appellate court, it is task of trial judge to determine, with all intellectual honesty that can be mustered, whether appellate court's reasoning is pertinent and thus controlling.

[6] BANKRUPTCY k2852

Secured portion of Internal Revenue Service's (IRS) tax claim secured by lien on Chapter 11 debtors' house and personal property had to be based on disposition value of house, rather than fair market value, where debtors intended to use house as personal residence and not as income-generating property. Bankr.Code, 11 U.S.C.A. § 506(a).

[7] BANKRUPTCY k2852

Valuation of secured portion of creditor's claim must be based on amount creditor is likely to get in reasonable disposition of collateral, rather than collateral's fair market value, unless proposed disposition or use of collateral is part of going concern and prospects for successful reorganization are good. Bankr.Code, 11 U.S.C.A. § 506(a).

[8] BANKRUPTCY k2852

Internal Revenue Service's (IRS) tax lien on Chapter 11 debtors' house was not void to the extent it secured unsecured IRS claim. Bankr.Code, 11 U.S.C.A. § 506(d).

[9] BANKRUPTCY k3413.1, Formerly 51k3413

Internal Revenue Service's (IRS) tax lien against Chapter 11 debtors' house was not rendered void through operation of plan requiring that IRS release lien upon satisfaction of secured portion of claim; plan could provide for separate treatments of secured and unsecured portions of claim. Bankr.Code, 11 U.S.C.A. § 506(a).

[9] BANKRUPTCY k3560

Internal Revenue Service's (IRS) tax lien against Chapter 11 debtors' house was not rendered void through operation of plan requiring that IRS release lien upon satisfaction of secured portion of claim; plan could provide for separate treatments of secured and unsecured portions of claim. Bankr.Code, 11 U.S.C.A. § 506(a).

Lavar Taylor, Burd & Marshack, Santa Ana, Cal., for debtors.

Lourdes G. Baird, U.S. Atty., Mason C. Lewis, Asst. U.S. Atty., Chief, Tax Div., Michael S. Noble, Sp. Asst. U S. Atty., Los Angeles, Cal., for U.S.

OPINION

VINCENT P. ZURZOLO, Bankruptcy Judge.

Donald and Madelaine TAFFI (the "TAFFIS"), plaintiffs in this adversary proceeding and reorganized debtors in this chapter 11 case, seek a judgment dividing the pre-bankruptcy tax claim of creditor and defendant the United States of America and its agency the Internal Revenue Service (the *107 "IRS") into secured and unsecured claims. The parties have properly presented their dispute to me by cross motions for summary judgment as they have stipulated to most pertinent facts and the remainder are not in dispute.

I. FACTS

The TAFFIS owe the IRS $496,940 for tax liabilities that arose in 1980 and 1981 (the "IRS Claim"). To secure payment of the IRS Claim, the IRS recorded a notice of federal tax lien on October 12, 1989 (the "Tax Lien"). The Tax Lien attached to the TAFFIS' personal residence (the "House"). Liens totaling $233,942.38 that encumber the House (the "Senior Liens") are prior in time and right to the Tax Lien.

In addition to the House, the TAFFIS own personal property worth approximately $10,000 (the "Personal Property"). The Personal Property is encumbered by a lien imposed by the IRS (the "Personal Property Tax Lien").

The House is worth $300,000 if sold to a willing and fully-informed buyer under normal market conditions (the "Fair

Market Value"). The transactional costs of such a consensual sale would be $27,000. If, however, the IRS liquidated the House to satisfy its claim, the IRS would recover only $240,000 (the "Liquidation Value").

On May 22, 1991, the TAFFIS commenced this chapter 11 case by filing a voluntary petition for relief under chapter 11. They initiated this adversary proceeding by filing a complaint on December 30, 1991. After appropriate disclosure, balloting, notice and hearing, I confirmed the TAFFIS' plan of reorganization (the "Plan") and the clerk of the court entered my order confirming the Plan on February 27, 1992. In the Plan, the TAFFIS provided for treatment of the secured and unsecured claims of the IRS. Under the Plan, the Tax Lien is to be released when the secured claim of the IRS is satisfied. The IRS made no objection to the Plan and the order confirming the Plan is final and has not been appealed or challenged in any way.

II. ISSUES PRESENTED

The parties present the following issues:

1. What is the amount of the IRS's allowed secured claim?

This question requires me to choose the appropriate standard of value--Fair Market Value or Liquidation Value. To answer it I must consider *In re Mitchell*, 954 F.2d 557 (9th Cir.1992).

2. Is the Tax Lien void to the extent it corresponds to the unsecured portion of the IRS Claim?

This issue turns on the meaning and effect of 11 U.S.C. § 506(d). The United States Supreme Court has recently

construed this subsection of Title 11 of the United States Code (the "Bankruptcy Code") in *Dewsnup v. Timm*, --- U.S. ----, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992).

The irony inherent in this dispute is that the TAFFIS urge me to apply the doctrine of stare decisis to the first issue and not to the second, while the IRS requests the converse.

III. DISCUSSION

My decision on these issues turns on the application of the doctrine of stare decisis. Before I explain my application of that doctrine to these issues, I will set out my understanding of it.

A. *STARE DECISIS*

"Stare decisis is defined in Black's Law Dictionary as meaning 'to abide by, or adhere to, decided cases.' Black's Law Dictionary 1406 (6th ed. 1990)." *Planned Parenthood of Southeastern Pennsylvania v. Casey*, 92 Daily Journal D.A.R. 8982, 9012 ("Casey") (opinion of Chief Justice Rehnquist and Justices White, Scalia and Thomas joining, concurring and dissenting in part). The doctrine is not founded on any statute. Rather, it is a judge-created rule grounded in fundamental policies respected by one of our most innovative jurists. For example, Justice Cardozo wrote:

> [I]n a system so highly developed as our own, precedents have so covered the ground that they fix the point of departure from which the labor of the judge begins. Almost invariably, his first step is to examine and compare them. If they are plain and to the point, there may be need of nothing more. Stare decisis is at least the every day working rule of our law.

Cardozo, The Nature of the Judicial Process 20 (1921).

In *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 90 S.Ct. 1772, 26 L.Ed.2d 339 (1970) the Court overturned one of its prior decisions by creating a remedy for wrongful death under federal maritime law. Justice Harlan, in writing for the Court, explained the significance of stare decisis:

> Very weighty considerations underlie the principle that courts should not lightly overrule past decisions. Among these are the desirability that the law furnish a clear guide for the conduct of individuals, to enable them to plan their affairs with assurance against undue surprise; the importance of furthering fair and expeditious adjudication by eliminating the need to relitigate every relevant proposition in every case; and the necessity of maintaining public faith in the judiciary as a source of impersonal and reasoned judgments.

Id. at 402, 90 S.Ct. at 1788.

[1] The Court has recently struggled with the application of stare decisis in reviewing its own precedents. See, e.g., Casey; *Payne v. Tennessee*, --- U.S. ----, 111 S.Ct. 2597, 115 L.Ed.2d 720 (1991), reh'g denied, --- U.S. ----, 112 S.Ct. 28, 115 L.Ed.2d 1110 (1991). It is uncontested, however, that inferior federal courts, including circuit courts of appeal, district courts and bankruptcy courts, are absolutely bound by the decisions of the Court on issues of law. *Jaffree v. Board of School Commissioners*, 459 U.S. 1314, 103 S.Ct. 842, 74 L.Ed.2d 924 (1983) (acting as circuit justice, Justice Powell stayed district court's judgment authorizing prayer in public school in knowing disobedience of prior decisions of the Court). This is true even if in the opinion of the inferior court, the Court has erred, *Id.* at 1315, 103 S.Ct. at 842-43, or the decision of the Court was summary and not plenary, *Hicks v. Miranda*, 422 U.S. 332,

344, 95 S.Ct. 2281, 2289, 45 L.Ed.2d 223 (1975) (district court bound by Court's summary determination that there was no substantial federal question).

[2] It is also true that in the absence of a decision of the Court on an issue of law, the decision of a court of appeals is binding on all inferior courts in that circuit. *Zuniga v. United Can Co.*, 812 F.2d 443, 450 (9th Cir.1987). This is so even if a split of opinion exists between the controlling circuit and another circuit court of appeals and the inferior court believes that the controlling circuit court is in error. *Id.* at 450; *Hasbrouck v. Texaco, Inc.*, 663 F.2d 930, 933 (9th Cir.1981), cert. denied 459 U.S. 828, 103 S.Ct. 63, 74 L.Ed.2d 65 (1982).

This hierarchical dimension of stare decisis is crucial to the efficient operation of the federal judicial system. If this hierarchy is not observed, then the goals expressed by the Court in Moragne cannot be accomplished. Second, and equally important, if inferior courts do not adhere to the precedents of the Court and circuit courts of appeals, those inferior courts usurp the role of the appellate courts and ultimately, Congress, which acts as the primary maker of law in our system of government. U.S. Const. art. I, § 1.

[3] Unfortunately, not all statutes enacted by Congress are precise in their wording and meaning. Federal courts must then construe those statutes. When the Court construes a statute, that construction is final and is deemed to become part of the statute, until or unless it is overturned by Congress. *Gulf, C. & S.F.R. v. Moser*, 275 U.S. 133, 136, 48 S.Ct. 49, 50, 72 L.Ed. 200 (1927). This is especially true when the Court construes a statute affecting rights in real property. *U.S. v. Title Ins. Co.*, 265 U.S. 472, 486, 44 S.Ct. 621, 623, 68 L.Ed. 1110 (1924). With the foregoing principles in mind, I turn to the issues before me.

B. VALUING THE HOUSE UNDER SECTION 506(a)

11 U.S.C. § 506(a) provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a) (emphasis added).

[4] It would appear from the above-quoted language that the value of a lien creditor's interest in collateral that is property of a bankruptcy estate must be determined after considering two factors: (1) the purpose of the valuation and (2) the proposed disposition or use of the property. In *Mitchell*, the Ninth Circuit applied this test to a used car.

The debtors in *Mitchell* proposed a plan in their chapter 13 case. At the hearing on confirmation of the plan, the bankruptcy court was asked to determine how much of the claim held by the creditor with a security interest in the *Mitchells'* Cadillac was secured. This determination was important because only the secured portion of the undersecured creditor's claim would be paid in full. The unsecured portion would only be paid 10% of its amount. *Mitchell*, 954 F.2d at 559.

The specific valuation choice faced by *Mitchell* court was whether the Cadillac should be given a wholesale value or a retail value for the purpose of treating the creditor's claim in the Mitchells' chapter 13 plan. The *Mitchell* court concluded that the language in 11 U.S.C. § 506(a) requiring the court to value the "creditor's interest," rather than the debtor's or the estate's interest, mandated the wholesale valuation. This is because the wholesale valuation more accurately approximated "what the creditor would obtain if the creditor were to make a reasonable disposition of the collateral." *Id.* at 560.

The Ninth Circuit placed heavy emphasis on the words "creditor's interest," and essentially ignored the language in Section 506(a) that requires that the valuation of collateral be made in light of the proposed disposition or use of the collateral. As Judge Noonan emphasized in his dissent to the majority opinion in *Mitchell*, "The key fact is that the debtor is going to use the car." *Id.* at 561 (Noonan, J., dissenting). The valuation was not being made in the context of a plan in which the debtor or the creditor would liquidate the collateral. In that context, the wholesale valuation would be appropriate in light of both requirements of 11 U.S.C. § 506(a).

The *Mitchell* court recognized that the use of wholesale value in eterminations under 11 U.S.C. § 506(a) is not universal. The courtconcluded that if "the collateral is being used as part of a going concern and the prospects for a successful reorganization are good" then the "retail" or "going concern" value would be appropriate. *Id.* at 560.

[5] The conclusions of law made by the *Mitchell* court are binding on me pursuant to the doctrine of stare decisis. Stare decisis can be difficult to apply, however, when the facts considered by the appellate court are substantially different than those in the pending dispute. It is then the task of the trial

judge to determine, with all the intellectual honesty that can be mustered, if the appellate court's reasoning is pertinent and thus controlling.

[6] In this case I am not asked to value a used car. Rather, I must decide the value of a personal residence, the House. Houses are not sold on a wholesale basis. Nor is there a true "retail" value for a house. Thus the polarity of value considered in *Mitchell* does not exist here. Nevertheless, the parties in this adversary proceeding have agreed that the IRS would realize only $240,000 if it sold the House at a forced tax sale, the only reasonable disposition that the IRS as a creditor can make of the House.

As the debtors in *Mitchell*, the TAFFIS intend to *use* the House. In this case, the TAFFIS intend to use the House as their personal residence and not as an income-generating property. Thus the instance in which fair market value is appropriate according to *Mitchell*, i.e. the collateral is being used as part of a going concern, does not apply in this case.

[7] The IRS argues that *Mitchell* is distinguishable because it concerns personal property and not real property. There is nothing in *Mitchell* that limits its application to personal property. The IRS also urges me to give appropriate emphasis to the requirement in Section 506(a) that the valuation of the creditor's interest in the collateral be determined in light of the proposed disposition or use. As the Plan does not propose a liquidation of the House, the IRS reasons that the Fair Market Value controls. The *Mitchell* court rejected essentially the same argument when it was made by the creditor with a security interest in the Mitchells' Cadillac. The Ninth Circuit has apparently decided that unless the proposed disposition or use of the collateral is part of a going concern and the prospects for successful reorganization are good, the appropriate standard of

valuation is what the creditor is likely to get in a reasonable disposition of its collateral. *Id.* at 560.

I conclude that in *Mitchell* the Ninth Circuit has construed statutory language to have a particular meaning. It would be disingenuous and contrary to the principles underlying stare decisis to determine that the language of 11 U.S.C. § 506(a) means something different when the collateral at issue is real and not personal property. This is so even when the *Mitchell* court's interpretation appears faulty on the facts and in view of the plain language of 11 U.S.C. § 506(a).

Based upon the forgoing, the IRS has an allowed secured claim in an amount equal to the value of the House plus the Personal Property ($240,000 + $10,000 = $250,000) less the Senior Liens ($233,942.38) for a total of $16,058.62 (the "Secured IRS Claim"). This means that under 11 U.S.C. § 506(a), the IRS has an allowed unsecured claim in the amount of $480,881.38 (the "Unsecured IRS Claim").

C. IS THE UNSECURED PORTION OF THE TAX LIEN VOID?

[8] 11 U.S.C. § 506(a) provides in pertinent in part as follows:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim.

11 U.S.C. § 506(a).

Subsection (d) of the same section of the Bankruptcy Code provides:

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless--
>
> (1) such claim was disallowed only under Section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under Section 501 of this Title.

11 U.S.C. § 506(d).

The exceptions set forth in subparagraphs (1) and (2) of subsection (d) quoted above have no role in this dispute. The plain language of these two subsections of Section 506 leads to only two logical conclusions: (1) the secured IRS Claim is an allowed secured claim within the meaning of Section 506(a); and (2) that portion of the Tax Lien that secures or pertains to the Unsecured IRS Claim is void.[1]

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[1] "Void" is not defined in 11 U.S.C. § 506 or anywhere else in the Bankruptcy Code. 11 U.S.C. § 550 discusses the consequences of the "avoiding" of a transfer under §§ 544, 545, 547, 548, 549, 553(b) and 724(a), but makes no reference to 11 U.S.C. § 506(d). 11 U.S.C. § 551 does provide that a lien rendered void under 506(d) is preserved for benefit of the estate. "Void" is defined in Black's Law Dictionary as "null; ineffectual nugatory; having no legal force or binding effect; unable in law to support the purpose for which it was intended. An instrument or transaction which is wholly ineffective, inoperative, and incapable of ratification and which thus has no force or effect so that nothing can cure it." Black's Law

The preceding construction of Section 506(d) is the same one reached by Justices Scalia and Souter in their opinion dissenting with the majority in *Dewsnup*. *Dewsnup*, --- U.S. at ---- - ----, 112 S.Ct. at 780- 81 (Scalia, J., and Souter, J. dissenting). Many federal judges who have construed Section 506(d) have reached the same conclusion.[2]

But for the majority opinion in Dewsnup, the plain language of Section 506(d) would draw me to this conclusion as well.

D. THE *DEWSNUP* MAJORITY'S CONSTRUCTION OF SECTION 506(d)

The facts in *Dewsnup* are straightforward. The Dewsnups were chapter 7 debtors who owned farmland that was worth less than the amount of debt encumbering it. The Dewsnups filed an adversary proceeding seeking a judgment declaring that the portion of the lien encumbering their farmland that pertained to the unsecured claim of the undersecured creditor was void. *Id.* at 776.

The procedural history is relatively simple as well. The *Dewsnup* trial court denied the debtors' request for relief by concluding that thebifurcation effect of Section 506(a) applied only to property in which thebankruptcy estate had an interest. The *Dewsnup* trial court assumed that the bankruptcy estate no longer had an interest in the farmland. It did not make an express finding of fact that the estate no longer had an interest

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Dictionary 1573 (5th ed. 1990).

[2] See, M. Howard, Stripping Down Liens: § 506(d) and the Theory of Bankruptcy, 65 Am.Bankr.L.J. 373, 374, n. 2 (1991).

due to the abandonment of the farmland by the estate to the debtors pursuant to 11 U.S.C. § 554. The United States District Court and the Court of Appeals for the Tenth Circuit each affirmed the conclusion of the *Dewsnup* trial court. *Id.* The Court granted certiorari in *Dewsnup* because the decision of the Tenth Circuit Court of Appeals in *Dewsnup* conflicted with the conclusion reached by the Third Circuit Court of Appeals in *Gaglia v. First Federal Savings & Loan Assoc.*, 889 F.2d 1304, 1306-11 (1989). *Dewsnup*, --- U.S. at ----, 112 S.Ct. at 776.

The *Dewsnup* majority begins its analysis by summarizing the conflicting positions of the parties to the appeal. *Id.* --- U.S. at ----, 112 S.Ct. at 776-77. Because the parties to the appeal disagreed in their respective constructions of Section 506(d), the *Dewsnup* majority concludes that there is an ambiguity in the statute. *Id.* --- U.S. at ----, 112 S.Ct. at 777.

Next, the *Dewsnup* majority treats this perceived ambiguity as an invitation to employ the following method of statutory construction: "[G]iven the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected." *Id.* --- U.S. at ----, 112 S.Ct. at 778. In other words, if a principle of law was embodied in statute or case law that was in effect prior to the enactment of the Bankruptcy Code, then that principle of law survives the enactment of the Code if: (1) the Code would effect a major change in pre-Code practice; (2) the change was not discussed in the legislative history of the Code; and (3) the Code's language is ambiguous. *Id.* --- U.S. at ----, 112 S.Ct. at 779.

Utilizing this analytical tool, the *Dewsnup* majority states that under pre- Code law, a lien would always pass through bankruptcy unaffected. *Id.* --- U.S. at ----, 112 S.Ct. at 778.

The only exception noted by the *Dewsnup* majority to this rule was if the debt secured by the lien was paid in full. *Id.* --- U.S. at ----, 112 S.Ct. at 779. As a result of this pre-Code principle of law and the perceived ambiguity in Section 506(d) of the Bankruptcy Code, the *Dewsnup* majority concludes its analysis by holding that Section 506(d) means that a lien is void only to the extent that the claim it secures is disallowed under 11 U.S.C. § 502. *Id.* The *Dewsnup* majority also holds that a lien is not void to the extent it secures a claim that is unsecured within the meaning of Section 506(a). *Id.*

The *Dewsnup* majority was anything but firm in its conclusion. In fact, the *Dewsnup* majority did everything but apologize for its holding. In one part of the opinion, the majority states "[H]ypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day." *Id.* --- U.S. at ----, 112 S.Ct. at 778. In the next paragraph of its opinion the *Dewsnup* majority continues its apologia: "Were we writing on a clean slate, we might be inclined to agree with petitioner that the words 'allowed secured claim' must take the same meaning in Section 506(d) as in Section 506(a)." *Id.* Considering that the Court was construing a statute that had created a conflict between two circuit courts of appeal and stirred controversy among courts and commentators for years,[3] *Dewsnup* is not the definitive pronouncement one would expect from the Court.

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[3] Howard, supra, at 373-75.

IV. PROBLEMS WITH *DEWSNUP* ANALYSIS

1. *No ambiguity in statutory language.*

I cannot find any ambiguity in the language of § 506(d). In his dissenting opinion, Justice Scalia cannot find any either. There is no point to repeating Justice Scalia's analysis and I defer to it. *Id.* --- U.S. at ----, 112 S.Ct. at 780 et seq. (Scalia, J., and Souter, J., dissenting.)

It is valuable to emphasize two points. There is no apparent ambiguity in the language of the statute. The only ambiguity one could reasonably find is that created by the legislative history to Section 506(d). Legislative history, of course, should not be consulted if the language of the statute is plain. *U.S. v. Ron Pair Enterprises*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). Second, the term "allowed secured claim" is found in both Section 506(a) and Section 506(d). The *Dewsnup* majority construed Section 506(d) so that the term has a different meaning than that found in Section 506(a). By assigning a different meaning to a term in one section of a statute than that given to other sections of the statute the *Dewsnup* court made it difficult for courts to construe the Bankruptcy Code in a consistent and rational manner.

2. *Even if Section 506(d) were ambiguous, pre-Code bankruptcy law was not as it is described by the Dewsnup majority.*

Assuming that the *Dewsnup* majority was correct in concluding that the language of Section 506(d) is ambiguous, it nevertheless erred in its recitation of pre-Code bankruptcy law regarding the stripping of a creditor's lien.

On --- U.S. at page ----, 112 S.Ct. at page 779 of *Dewsnup*, the Court summarizes pre-Code bankruptcy law as follows:

> Apart from reorganization proceedings, ... no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt. Our cases reveal the Court's concern about this. In *Long v. Bullard*, 117 U.S. 617, 620-621, 6 S.Ct. 917, 918, 29 L.Ed. 1004 (1886), the Court held that a discharge in bankruptcy does not release real estate of the debtor from the lien of a mortgage created by him before the bankruptcy. And in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935), the Court considered additions to the Bankruptcy Act effected by the Frazier-Lemke Act, 48 Stat. 1289 (1934). There the Court noted that the latter Act's 'avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property.' *Id.* at 594, 55 S.Ct. at 865.
>
> The Court invalidated that statute under the Takings Clause. It further observed: 'no instance has been found, except under the Frazier- Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full.' *Id.* at 579, 55 S.Ct. at 858.

Dewsnup, --- U.S. at ----, 112 S.Ct. at 779.

The Court in *Long* did not conclude that under pre-Code law, a lien could not be involuntarily reduced for reasons other than payment on a debt. Rather, the Court in *Long* concluded

that the discharge granted in bankruptcy only extinguishes the debtor's personal liability for the debt. It does not release collateral subject to a lien securing the debt that is discharged. *In re Pence*, 905 F.2d 1107, 1109 (7th Cir.1990); Howard, *Dewsmupping the Bankruptcy Code*, 1 Journal of Bankruptcy Law and Practice 513, 524-30.

The *Dewsmup* court's discussion of the constitutionality of the Frazier-Lemke Act is also inaccurate, or at least incomplete. The Court's decision in *Radford* invalidated a statute that *retroactively* impacted on lienholder's rights by allowing debtors to purchase property by making deferred payments that totalled less than the present value of the collateral. *Radford*, 295 U.S. at 591-93, 55 S.Ct. at 864-65; Howard, *Dewsmupping the Bankruptcy Code supra*, at 524-25. It was the retroactive nature of the statute that made it unconstitutional. Once the Frazier-Lemke Act had been revised to provide the lienholder with payments equal to the full value of the collateral and to only apply prospectively, its constitutionality was upheld. *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440, 57 S.Ct. 556, 81 L.Ed. 736 (1937).

In light of the foregoing, it does not appear that the *Dewsmup* court was correct in its conclusion that pre-Code bankruptcy law prohibited the involuntary reduction of a creditor's lien by paying a creditor the present value of the secured portion of its claim.

E. APPLICATION OF *DEWSNUP* TO THE TAX LIEN

Based upon the foregoing analysis, I disagree with the *Dewsmup* majority's construction of 11 U.S.C. § 506(d). Nevertheless, stare decisis binds me to the *Dewsmup* majority's conclusion of law. A judge seeking to avoid the *stare decisis* effect of *Dewsmup* could ask the question, "Can the holding in

Dewsnup be distinguished because the facts in *Dewsnup* are different from the facts in the present dispute?"

The TAFFIS have argued that the *Dewsnup* construction of 11 U.S.C. § 506(d) should be limited to those cases in which a chapter 7 debtor seeks to render void an unsecured lien. This argument is supported by the very language of the *Dewsnup* majority: "Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficult of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day." *Dewsnup*, --- U.S. at ----, 112 S.Ct. at 778.

This argument would be persuasive if 11 U.S.C. § 506(d) were enacted as part of chapter 7 of the Bankruptcy Code. 11 U.S.C. § 103(b), (c) and (d). The subsection in question, however, was enacted as part of chapter 5 of the Bankruptcy Code. 11 U.S.C. § 103(a) provides: "Except as provided in Section 1161 of this Title, chapters 1, 3, and 5 of this Title apply in a case under chapter 7, 11, 12 or 13 of this Title." Section 1161 does not apply to 11 U.S.C. § 506(d).

Despite the above quoted qualification of the *Dewsnup* majority, the Court did not just apply a statute to a particular set of facts. It construed the meaning of a statute that applies in cases under many chapters of the Bankruptcy Code. Thus, that construction must be applied to all disputes arising under chapters 7, 11, 12, and 13.

One court has concluded that *Dewsnup* does not apply in chapter 11. *In re Butler*, 139 B.R. 258 (Bnkr.E.D.Okla.1992). The Butler court based its reasoning on the statement in *Dewsnup* that "[A]part from reorganization proceedings, ... no provision of the pre-Code statute permitted involuntary

reduction of the amount of a creditor's lien for any reason other than payment on a debt." *Dewsnup*, --- U.S. at ----, 112 S.Ct. at 779. The *Butler* court also made reference to the *Dewsnup* language proportedly limiting its holding to the facts before it. *Butler*, 139 B.R. at 258. The *Butler* court goes on to conclude that it is therefore appropriate to limit the holding of *Dewsnup* to chapter 7 cases and to do otherwise would "gut the sum and substance of the reorganization and rehabilitation of debt concept under the Bankruptcy Code." *Id.* Finally, the *Butler* court states the dissenting opinion in *Dewsnup* is compelling. *Id.*

Although I prefer the result in *Butler* to that in *Dewsnup*, I do not believe I have the discretion to choose. I find the reasoning in *Butler* unpersuasive for the reasons stated above,--the Court construed a statute that applies in all chapters. The language quoted by *Butler* concerns the Court's rationale for *why* it chose the construction of 506(d) that it did. Nowhere in *Dewsnup* can I find the conclusion that 506(d) means one thing in chapter 11 and another in chapter 7. It should also be noted that to construe a section of chapter 5 of the Bankruptcy Code to have a different meaning in chapter 7 than it has in chapter 11 would involve the same faulty statutory analysis engaged in by the *Dewsnup* majority and criticized in the *Dewsnup* dissent. *Dewsnup*, --- U.S. at ---- - ----, 112 S.Ct. at 780-81.

I conclude that stare decisis requires me to apply the *Dewsnup* court's construction of 11 U.S.C. § 506(d) even though I find it to be in error. As a result, the Tax Lien is not void to the extent its secures the Unsecured IRS Claim.

F. *DEWSNUP*, 506(d) AND THE PLAN

[9] The TAFFIS argue that if I do not conclude that 11 U.S.C. § 506(d) renders the tax lien void on its own, the tax lien is nonetheless void through operation of the Plan. The argument is premised on the provision of the Plan that provides that the IRS shall release the Tax Lien upon satisfaction of the Secured IRS Claim. Thus, the TAFFIS conclude that the Tax Lien should be void to the extent it secures the Unsecured IRS Claim pursuant to the Plan. Otherwise, it is argued, the election

embodied in 11 U.S.C. § 1111(b),[4] which was not utilized by IRS in this case, would be meaningless.

I disagree. The TAFFIS' argument is premised on the failure to distinguish between a lien that is rendered void and a lien that must be released because the claim underlying it is satisfied. If I could apply 11 U.S.C. § 506(d) as Congress

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[4] Section 1111. Claims and interests.

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless--

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if--

(i) the interest on account of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

wrote it, the Tax Lien would be void to the extent it pertained to the Unsecured IRS Claim. This would be true with or without confirmation of the Plan. This is because there is no such qualification or requirement in 11 U.S.C. § 506(d). This result is barred, however, by *Dewsnup*.

Nothing in *Dewsnup*, however, bars a chapter 11, 12, or 13 plan proponent from dividing an undersecured claim into separate secured and unsecured claims under Section 506(a). Assuming the plan meets all other requirements for confirmation set forth in the respective chapters of the Bankruptcy Code, the proponent could satisfy the separate secured and unsecured claims through confirmation of a plan and, most importantly, through consummation of a plan. If the proponent completes the treatment proposed by the plan and satisfies the secured and unsecured claims of the undersecured creditor then the lienholder would be required under non-bankruptcy law to release the lien from the property of the reorganized debtor. See, e.g., 26 U.S.C. § 6325.[5]

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[5] Release of lien or discharge of property

(a) Release of lien.--Subject to such regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of release of any lien imposed with respect to any internal revenue tax if--

(1) Liability satisfied or unenforceable.--The Secretary or his delegate finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied or has become legally unenforceable.

This is exactly the conclusion reached by the Second Circuit in *In re Bellamy*, 962 F.2d 176 (2d Cir.1992). In *Bellamy*, the undersecured creditor argued that the decision in *Dewsnup* barred the chapter 13 debtor from dividing the creditor's claim into secured and unsecured claims under 11 U.S.C. § 506(a) and treating them differently through a plan, i.e., the secured claim would be paid 100 cents on the dollar and the unsecured claim would only receive 10 cents on the dollar. The Second Circuit Court of Appeals concluded that nothing in *Dewsnup* barred the debtors from bifurcating the undersecured creditor's claim under Section 506(a) and then treating and satisfying the resulting secured and unsecured claims through the debtor's chapter 13 plan.

In this case, the Plan provides for separate treatments of the Secured IRS Claim and the Unsecured IRS Claim. The Secured IRS Claim will be paid in full and the Unsecured IRS Claim will be satisfied by payment of a fraction of its amount. The IRS did not object to this treatment and has not challenged the Plan or the order confirming it.

This result is consistent with 11 U.S.C. §§ 506(a) and 1111(b). If the IRS wanted the Unsecured IRS Claim to be treated the same as the Secured IRS Claim, it only needed to make its election under 11 U.S.C. § 1111(b). Then the TAFFIS would have been required to pay the Unsecured IRS Claim in full to obtain a release of the Tax Lien through the Plan. Thus there is nothing in *Dewsnup* that prevents the TAFFIS from confirming and consummating the Plan, and specifically satisfying of the Secured IRS Claim and the Unsecured IRS Claim and obtaining the eventual release of the Tax Lien.

V. CONCLUSION

Based upon the foregoing, summary judgment is granted in favor of the TAFFIS in that the valuation of the House is controlled by *Mitchell*. Summary judgment is granted in favor of the IRS in that the decision in *Dewsnup* means that the Tax Lien is not void simply because the IRS is undersecured. The foregoing constitutes my findings of fact and conclusions of law. The prevailing parties shall lodge proposed judgments consistent with the foregoing.

Supreme Court, U.S.
FILED
DEC 26 1996

No. 96-881

In the Supreme Court of the United States

OCTOBER TERM, 1996

DONALD AND MADELAINE TAFFI, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether, when a debtor in a bankruptcy case is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be valued under Section 506(a) of the Bankruptcy Code at (i) the amount the creditor would realize from a hypothetical foreclosure sale of the property or (ii) the fair market value of the property in the hands of the debtor.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-881

DONALD AND MADELAINE TAFFI, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals on rehearing en banc (Pet. App. 1-7) is reported at 96 F.3d 1190. The panel opinion of the court of appeals (Pet. App. 8-23) is reported at 68 F.3d 306. The opinion of the district court (Pet. App. 24-34) is reported at 72 A.F.T.R.2d 93-6607. The opinion of the bankruptcy court (Pet. App. 35-60) is reported at 144 B.R. 105.

JURISDICTION

The judgment of the court of appeals was entered on September 17, 1996. The petition for a writ of certiorari was filed on October 31, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT

1. In 1991, petitioners Donald and Madelaine Taffi filed for bankruptcy under Chapter 11 of the Bankruptcy Code (Pet. App. 39). Prior to the bankruptcy filing, the Internal Revenue Service made an assessment against petitioners for 1980 and 1981 taxes in the amount of $496,940, and a notice of federal tax lien had been filed for that amount (*id.* at 38). That tax lien attached to the debtors' personal residence and to approximately $10,000 in personal property (*ibid.*).

Petitioners proposed a bankruptcy plan under which they would retain their house and continue to live in it (Pet. App. 45). The parties to the bankruptcy proceeding stipulated that, under normal market conditions, the house would sell for $300,000 and, after

selling costs of 9 percent were deducted, would clear $273,000 (*id.* at 38-39). The parties further stipulated, however, that the house would clear only $240,000 in a forced or liquidation sale (*id.* at 39). Because liens on the house that were senior to the tax lien totaled $233,942.38 (*id.* at 38), the government would thus realize $66,058 in a normal or fair market value sale of the house (or $39,058 after selling costs were deducted) but would realize only $6,058 in a forced sale.

Under the bankruptcy plan submitted by petitioners, they proposed to retain their house and to value the government's secured tax claim at the amount that would be realized from a forced sale of the house (plus $10,000 for the personal property to which the tax lien had also attached). The plan proposed by petitioners was a "cramdown" plan, under which the debtor seeks confirmation of a plan despite a creditor's objections. In a "cramdown" plan, the amount of a secured claim is reduced to an "allowed secur ed claim" under the valuation provisions of Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a).[1] The portion of the secured claim that is not treated as an "allowed secured claim" under that provision is treated as an unsecured claim. *Ibid.*

The bankruptcy court approved both the plan and the valuation of the allowed secured tax claim that petitioners proposed (Pet. App. 46). The district court, however, reversed the determination of the value of the allowed secured tax claim (*id.* at 24-34). The district court held that, because the plan allowed the debtors to retain the house, the "allowed secured amount" of the federal tax claim is the fair market

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[1] The creditor retains a lien to protect its secured claim. 11 U.S.C. 1129(b). See also 11 U.S.C. 1325(a)(5)(B)(i), (ii).

value of the house without any deduction for selling costs (*id.* at 32-33).

2. A panel of the Ninth Circuit affirmed. The panel opinion agreed with the district court that, when the debtor is permitted to retain the property to which the creditor's lien has attached, the proper measure of the "allowed secured claim" is the fair market value of the property. The court concluded that Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), does not authorize the deduction of hypothetical foreclosure costs when the property will not in fact be sold at a foreclosure (Pet. App. 16-17).

3. On rehearing en banc, the court of appeals agreed with the panel decision. The en banc court held that, when the debtor retains the collateral that secures the creditor's secured claim, the amount of the "allowed secured claim" under Section 506(a) is not the amount that the creditor would obtain in a hypothetical foreclosure sale of the collateral but is, instead, the "fair market value of what the debtors are using" (Pet. App. 5). The court noted that its interpretation of Section 506(a) conflicted with the en banc opinion of the Fifth Circuit in *Associates Commercial Corp.* v. *Rash*, 90 F.3d 1036 (1996), petition for cert. pending, No. 96-454, but was "in harmony with" prior decisions of the First, Fourth, Sixth and Eighth Circuits (Pet. App. 6).

ARGUMENT

As the court of appeals noted in its en banc decision (Pet. App. 6), there is a conflict among the circuits on the question presented in this case. The proper valuation of secured claims in the situation where the debtor is permitted to retain the collateral over the objection of the secured party is a frequently recur-

ring question of substantial importance. Resolution of this recurring question by this Court is needed to avoid repetitive and wasteful litigation and to ensure evenhanded treatment of debtors under the many federal programs that authorize or establish secured claims for the United States, as well as evenhanded treatment of debtors and secured creditors generally.

1. This case involves the proper valuation of a secured claim in a bankruptcy case when the debtor is permitted to retain the property that secures the claim. When, as in the present case, a debtor proposes to retain such property under a plan to which the creditor has objected, the court may approve the plan only if, among other requirements, the holder of the secured claim will receive at least the value of the "allowed amount" of the secured claim. 11 U.S.C. 1129(b)(2)(A)(i)(II). See also 11 U.S.C. 1325(a)(5)(B). The "allowed amount" of such a claim is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). H.R. Rep. No. 595, 95th Cong., 1st Sess. 415 (1977). That Section specifies that a secured claim is to be treated as an "allowed" secured claim only to the extent of "the value of such creditor's interest in the estate's interest in such property" (11 U.S.C. 506(a)). This statute further specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*). To the extent that the secured claim exceeds the value thus determined, it is treated as an unsecured claim (*ibid.*).

With the exception of the recent decision of the Fifth Circuit in *Associates Commercial Corp.* v. *Rash*, *supra*, all of the courts of appeals that have interpreted the valuation provisions of Section 506(a) have rejected using "foreclosure value" as the mea-

sure of value when the debtor retains the collateral. These courts include the Ninth Circuit in the present case (Pet. App. 6), the Eighth Circuit (*Metrobank* v. *Trimble*, 50 F.3d 530 (1995) (Chapter 13 case valuing pickup truck)), the First Circuit (*Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Institution for Savings*, 50 F.3d 72 (1995) (Chapter 11 case valuing real property used in business)), the Sixth Circuit (*Huntington National Bank* v. *Pees* (*In re McClurkin*), 31 F.3d 401 (1994) (Chapter 13 case valuing real property used as residence)) and the Fourth Circuit (*Brown and Company Securities Corp.* v. *Balbus*, 933 F.2d 246 (1991) (Chapter 13 case valuing real property); *Coker* v. *Sovran Equity Mortgage Corp.*, 973 F.2d 258 (1992) (same)).[2]

Less than two months before the Ninth Circuit issued its en banc opinion in this case, the Fifth Circuit, also sitting en banc, held (with six dissenting judges) that Section 506(a) permits the allowed amount of a secured claim to be reduced to the foreclosure value of the property securing that claim, even when the debtor retains the property. *Associates Commercial Corp.* v. *Rash*, 90 F.3d at 1060. In this case, however, the court of appeals expressly disagreed with the reasoning and conclusion of the Fifth Circuit's decision in *Associates Commercial*

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[2] Petitioners err in contending (Pet. 6 n.1) that *Winthrop*, *McClurkin* and *Coker* are not "in harmony" with the decision in this case. In each of those decisions, the court rejected the notion—also rejected by the Ninth Circuit in this case (Pet. App. 6)—that the value of a secured claim must be based on what the creditor would realize if it sold the collateral outside of bankruptcy. See 50 F.3d at 75; 31 F.3d at 405; 973 F.2d at 260.

Corp. (Pet. App. 6). The court stated in the present case that (*id.* at 5):

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. * * * Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using.

The conflict between the en banc decision of the Fifth Circuit in *Associates Commercial Corp.* and the decisions of the First, Fourth, Sixth, Eighth and Ninth Circuits is direct and irreconcilable. Unless resolved by this Court, this conflict will produce wasteful and repetitive litigation and will result in disparate treatment of secured claims in bankruptcies based solely on geographical happenstance.

2. a. The question presented in this case and in the pending petition in *Associates Commercial Corp.* is of substantial importance. As petitioners note (Pet. 5), approximately 300,000 bankruptcy cases were filed under Chapters 11 and 13 of the Bankruptcy Code in 1995. The Internal Revenue Service advises us that, during the year ending September 30, 1996, the Service filed proofs of claim in approximately 162,000 bankruptcy cases, asserting $329,830,957 in secured claims in Chapter 11 cases and $334,812,254 in secured claims in Chapter 13 cases.

The United States is also a secured creditor in a variety of other contexts. To list only a few examples, the United States may assert liens for payment of penalties under agricultural quota programs and for the repayment of agricultural loans (7 U.S.C. 1314(c), 1339(a)(1), 1340(4), 1927(c)), for repayment of advances made under defense contracts (10 U.S.C. 2307(d)), for payment of certain criminal fines (18 U.S.C. 3613(c)), for payment of customs duties (19 U.S.C. 198), for payment of a judgment lien in favor of the United States in a civil action (28 U.S.C. 3201(a)), for payment of pension benefits under the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1368(a)), for repayment of black lung benefits (30 U.S.C. 934(b)(2)), for repayment of advances made to a contractor by a government agency (41 U.S.C. 255(d)), for repayment of low-income housing loans (42 U.S.C. 1484(a)(5), 1487(d)(1)), for payment of the costs of removing or remediating hazardous substances (42 U.S.C. 9607(*l*)(1)) and for payment of charges due under a federal irrigation project (43 U.S.C. 542).

The United States is thus a secured creditor in a large portion of all Chapter 11 and Chapter 13 bankruptcy cases. If the secured claim of the government in these cases were reduced under the foreclosure valuation method advanced by petitioners and adopted by the Fifth Circuit in the *Associates Commercial Corp.* case, the loss of revenue to the Treasury would be substantial.

b. Because of the conflict among the circuits created by the decision in *Associates Commercial Corp.*, two taxpayers who owe the same amount of tax and possess assets of the same value ultimately may pay significantly different amounts of their federal tax liability depending solely upon the happenstance

of geography. This disparate treatment impedes the objective of "ensur[ing] as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). See also *Lyeth* v. *Hoey*, 305 U.S. 188, 193 (1938). It similarly prevents the uniform application of other federal programs that authorize or create secured claims for the government. Review by this Court is warranted to resolve the continuing conflict among the circuits on the recurring question presented in this case.

3. The question presented in this case and in *Associates Commercial Corp.* is, in our view, ultimately the same, although the issue arises in different contexts. In particular, *Associates Commercial Corp.* is a Chapter 13 case in which the collateral that the debtors propose to retain for their own use is personal property used in the debtors' business. The present case is a Chapter 11 case in which the collateral that the debtors propose to retain is the debtors' residence. To ensure that a decision on either of these two petitions resolves the underlying question in all relevant contexts, the Court may wish to consider granting both petitions and either consolidating them or setting the cases for argument in tandem. Alternatively, we would suggest that the Court grant the present petition and hold the petition in *Associates Commercial Corp.*, No. 96-454, pending its decision in this case.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted.

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